

SHARE PRICE PERFORMANCE AND REGIME CHANGES AT IPO LOCKUP EXPIRATION IN MALAYSIA

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Abstract

This paper examines the effect of IPO lockup expiration on share price performance surrounding the event date involving two lockup regimes. The sample consists of 292 IPOs listed on Bursa Malaysia from May 1, 2003 to December 31, 2012. IPO Lockup in Malaysia is mandatory where it is regulated by the Securities Commissions compared to voluntary lockup where it is negotiated between IPO firms and their underwriters. Using the market model event study method, the result shows a significant negative abnormal return at the expiration of the lockup period. Thus, the study provides evidence that contradicts the semi-strong form of the Efficient Market Hypothesis (EMH). According to EMH, the expiration of the lockup period which is public knowledge should not be accompanied with a significant abnormal return. In addition, the evidence also shows that the change in lockup regime does not have an impact in reducing the negative abnormal returns at the expiration of the first stage lockup period.

Keywords: event study, IPO, lockup provisions

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Introduction

An Initial Public Offering (IPO) is where a firm's share is offered to the public for the first time. In this event, a firm creates new shares, or existing shareholders offer to dispose a certain fraction of their own shares, causing in the change of the ownership structure. These shares are initially sold on the primary market, leading to its debut on the Stock Exchange. The terms lockup, lock-in and share moratorium which are used in the US, the UK and Malaysia, respectively have similar meaning which is an important component of IPOs. It refers to the restricted period during which the insiders (promoters as in Malaysia) are prohibited from selling their shareholdings after the listing. Once the lockup period expires, insiders are free to liquidate their locked-up shares. This could lead to a substantial influence on the market because the number of shares available in the market increases extremely.

Most IPOs have lockup provisions which are disclosed in the IPO prospectus and there are several reasons that can be associated with the existence of lockup agreements. Besides preventing selling pressure from insiders and keeping them in the execution of the firm's strategy, lockup agreements also ensure the incentives between the insiders and outsiders are closely aligned, provide a commitment device to moral hazard problem, and serve as a rent extraction mechanism for influential underwriters. Furthermore, the requirements of lockup period vary from one country to another. There are two types of lockup agreements engaged by IPO firms; either mandatory or voluntary. A mandatory lockup is regulated by the regulators in the country, whereas a voluntary lockup is an agreement between IPO issuers and their underwriters.

In Malaysia, lockup is regulated by the Securities Commission (SC), where the percentage of shares locked and the lockup length are fixed. Beginning to be effective on 3 May 1999 for some IPO firms, there have been regulation changes in May 2003 and August 2009 with regards to lockup provisions. The present regulation seems to be most restrictive where all IPO firms are subjected to lockup provisions whereby the entire shareholdings of the promoters are locked-up for a six-month period. There are two lockup regimes involved in this study which are represented by Regime #1 and Regime #2 where the revisions of the lockup provisions take place effective from 1 May 2003 and 3 August 2009, respectively. Meanwhile, the Bursa Malaysia which is previously known as the Kuala Lumpur Stock Exchange (KLSE) consists of two markets, namely the Main Market and the ACE Market. However, the multi-staged lockups are imposed only on the ACE Market.

In connection with the semi-strong form of the Efficient Market Hypothesis (EMH), the current price fully incorporates all publicly available information which coincides with the public knowledge of the lockup expiration dates at the time of the IPO. Hence, there should be no predictable share price movements at the expiry of the lockup periods. In line with this, Ofek and Richardson (2000) and Brav and Gompers (2000) argue that since the date of the lockup expiration is known when the company goes public, this price impact should be captured by the market immediately after the IPO begins trading. Thus, on average, the abnormal return around the lockup release should be zero. However, previous studies either mandatory or voluntary lockup agreements on share price impact have documented mixed evidence in terms of supporting or contradicting the EMH.

This study adds to the literature by examining the share price performance and lockup regime changes at the expiration of IPO lockup period in Malaysian market by focusing on the first

stage lockup expiry. The remainder of this paper describes the research method designed for the study, discusses the empirical results of share price performance at lockup expiration and lockup regime changes, and it ends with a conclusion the study.

Literature Review

The effect of lockup period is motivated mainly by the observation of the market reaction at its expiration. Pioneering work on lockup expirations is found in well-known studies originated from the US (e.g., Ofek & Richardson, 2000; Brav & Gompers, 2000 & 2003; Field & Hanka, 2001; Bradley et al., 2001; Brau et al., 2004). However, since Brav and Gompers (2003) request for more research using the variation in global lockup requirements, studies from international share markets began to surface. Other US studies are reported by Gao (2005) and, Yung and Zender (2010) where they also provide similar results of significant negative abnormal returns. Gao and Siddiqi (2012) explore the voluntary agreements by IPO firms to lockup longer period and find that these agreements are used to control agency costs. Moreover, Chen et al. (2012) examine long run returns subsequent to lockup expiration and find that returns are negatively associated with abnormal selling by senior executives while unrelated to selling are by other insiders.

Meanwhile, studies outside the US such as the UK, Europe and Asia have reported mostly insignificant negative abnormal returns at the expiration of the lockup periods. Espenlaub et al. (2001) observe statistically insignificant negative abnormal returns while Hogue (2011) finds significant negative abnormal returns UK IPOs. Ahmad and Jelic (2014) examine the role of lockup agreements on the survival of 580 UK IPOs during the period 1990-2011 and find that the failure rates for IPOs with longer lockups are consistently lower than the failure rates for IPOs with shorter lockups regardless of delisting reasons. In Germany, Nowak (2004) finds significant negative abnormal returns while Goergen et al. (2006) show insignificant negative abnormal returns for both France and Germany. In Italy IPOs, Boreiko and Lombardo (2013) also do not find any significant abnormal returns.

In Asia, few studies are conducted in relation to IPO lockup expiration on share price. Chen et al. (2005) find insignificant negative abnormal returns at lockup expiry in Taiwanese IPO whereas in Hong Kong, Goergen et al. (2010) also find insignificant change in share price. Similarly, Mahajan and Singh (2011) examine 165 lockup period expirations in India where the results show insignificant share price reaction. In other countries, Kryzanowski and Liang (2008) examine Canadian IPOs while Hakim et al. (2012) observe the IPOs in the Middle East and North Africa (MENA) region. Both studies provide mixed evidence where significant negative abnormal returns are reported only in MENA region. In Malaysia, studies on lockup are conducted by Zamani and Yong (2016) who examine the trading volume behaviour, Che-Yahya et al. (2015) examine the impact of lockup provision on two IPO anomalies in the immediate aftermarket, Mohd-Rashid et al. (2014) explore the influence of lockup provisions on IPO initial returns, and Che-Yahya et al. (2013) examine the influence of lockup provisions on flipping activity.

Methodology

The data used in this study are those IPO firms listed on Bursa Malaysia from May 1, 2003 to December 31, 2012. May 1, 2003 is chosen as a starting period since it represents the first regulatory change in relation to lockup period after it is made compulsory on 3 May 1999. Both databases of Bursa Malaysia website and DataStream are used as data sources. In addition, several data conditions are imposed in order to include in the final sample; an offering involving new ordinary shares only, the firms are subjected to lockup provisions and remained listed throughout the expiration of the lockup period, and must be incorporated in Malaysia. Furthermore, firms listed under Finance, Trust, REITs, and Closed-End Funds sectors are excluded due to different statutory requirements in preparing firms' annual reports. After imposing these selection criteria, of the 328 IPO firms identified, only 292 IPOs made up the final sample.

To examine the share price reaction to lockup expiration, event study method is employed. Abnormal returns surrounding the expiration of lockup period is estimated using the market model as stated in equation (1):

$$R_{it} = \alpha_i + \beta_i R_{mt} + \epsilon_{it} \quad (1)$$

where R_{it} is the return for firm i on day t in estimation period, R_{mt} is the average returns for all firms in Bursa Malaysia on day t (FBM KLCI is used as the market index), α_i and β_i are the intercept and the slope parameters for firm i , and ϵ_{it} is the error term. Abnormal returns for each firm are calculated by finding the difference between actual returns and expected returns for a given time period as shown in equation (2):

$$AR_{it} = R_{it} - (\alpha_i + \beta_i R_{mt}) \quad (2)$$

Results and Discussion

Table 1 shows the average abnormal returns (AARs) and cumulative average abnormal returns (CAARs) surrounding the lockup expiration over 21-day event window. The daily average abnormal returns are significantly negative at 1% level on day -7 and day +1 with returns of -0.62% and -0.59%, respectively. Meanwhile, for the closer period surrounding the unlock day, the AARs are negative on day -4 through day +3, except on day 0. The returns ranged from -0.14% on days -3 and -2 to -0.59% on day -1. Table 1 also tabulates the cumulative average abnormal returns (CAARs) around the expiration of the lockup. Virtually, CAARs are found to be negative and appear to be quite small from day -7 to day -4. However, from day -3 to day +10, the cumulative returns are larger where it peaks at -1.47% on day +3.

Table 1: AAR and CAAR around Lockup Expiry Date

Day	AAR(%)	P-value	CAAR(%)
-10	-0.22	0.2931	-0.22
-9	0.41	**0.0475	0.19
-8	-0.06	0.7640	0.13
-7	-0.62	***0.0030	-0.49
-6	0.23	0.2707	-0.26
-5	0.12	0.5765	-0.14
-4	-0.22	0.2808	-0.36
-3	-0.14	0.4893	-0.51

-2	-0.14	0.5096	-0.65
-1	-0.30	0.1493	-0.94
0	0.43	**0.0376	-0.51
1	-0.59	***0.0048	-1.10
2	-0.21	0.3147	-1.31
3	-0.16	0.4406	-1.47
4	0.21	0.3217	-1.26
5	-0.04	0.8492	-1.30
6	0.25	0.2357	-1.05
7	-0.31	0.1396	-1.36
8	-0.01	0.9540	-1.37
9	0.19	0.3670	-1.19
10	0.00	0.9905	-1.19

***Significant at 1% level, **Significant at 5% level, *Significant at 10% level

Meanwhile, Table 2 presents the cumulative average abnormal returns (CAARs) for several event windows. Different results are observed for CAARs around the expiration date. Significant negative returns are recorded at smaller windows surrounding the event date for windows (-3, +3), (-2, +2) and (-1, +3). Only window (-3, +3) is significant at 5% level with return of -1.10%, whereas the other two windows are observed to be significant at 10% level with returns of -0.80% and -0.82% for windows (-2, +2) and (-1, +3) respectively. For the five-day event window (-2, +2), the negative abnormal return is in line with the findings of Bradley et al. (2001) with returns of -1.61%, being significant at 1% level. For the other 5-day event window (-1, +3), the significant return of -0.82% corresponds with Ofek and Richardson (2000) five-day cumulative abnormal return for window (-4, 0) amounting to -2.03%, which is significant at 1% level. Furthermore, event window of seven-day (-3, +3) is significantly negative at 5% level with CAAR of -1.10%. The significant negative return is corresponding with the CAAR of -1.9% as reported by Field and Hanka (2001) for seven-day window (-5, +1) with significant level of 1%. Table 1 and Table 2 are shown below, respectively.

Table 2: Cumulative Average Abnormal Returns for various event windows

Event Window	CAAR (%)	p-value
(-10,+10)	-1.19	0.2117
(-10,-1)	-0.94	0.1504
(-5,+5)	-1.04	0.1294
(-5,-1)	-0.69	0.1384
(-3,+3)	-1.10	**0.0448
(-3,-1)	-0.58	0.1069
(-2,+2)	-0.80	*0.0853
(-1,+1)	-0.45	0.2077
(-1,+3)	-0.82	*0.0766
(-1,+5)	-0.66	0.2326
(-1,+10)	-0.54	0.4499

***Significant at 1% level, **Significant at 5% level, *Significant at 10% level

From the results presented, this study shows statistically significant negative abnormal returns at the expiration of the lockup period which is in line with the US studies. However, both the negative abnormal returns and the significant levels are slightly lower for this study with mandatory lockup provisions compared to those reported in the US which adopted

voluntary lockup agreements. In line with this, Hakim et al. (2012) find that prices decline at lockup expiration for mandatory lockup in the MENA region much the same as in the US. Consistent with the study reported by Nowak (2004), the drop in share price is significantly larger for the expiration of voluntary lockup agreements than for mandatory lockup provision. The existence of the significant negative abnormal returns surrounding the lockup expiration further indicates the contradicting evidence of the efficient market hypothesis.

As indicated earlier, there are two lockup regimes involve in this study. Regime #1 represents the lockup provision with effect from 1 May 2003 whereas Regime #2 belongs to the lockup provision starting from 3 August 2009, arising from the new framework in Malaysian capital market. Along with the new structure, there is also a significant shift in the regulatory approach with regards to lockup period by the Securities Commission. Hence, the impact of these regulation changes is further explored on the abnormal returns. To provide further insight, statistical significance of the abnormal returns between these two regimes at lockup expiration needs to be examined. First, the independent samples t-test with unequal variances is conducted. This is followed by the nonparametric test for independent samples whereby various event windows are used for both tests. Results of the statistical tests are tabulated in Table 3 as shown below.

Table 3: Independent samples t-test and nonparametric test for lockup regimes

Event Window	Regime #1 (%)	Regime #2 (%)	p-value (Mean Difference)	p-value (Mann-Whitney)
(-10,+10)	-4.343	-12.052	0.505	0.731
(-10,-1)	-4.199	-0.343	0.234	0.629
(-5,+5)	-4.250	-0.598	0.292	0.402
(-5,-1)	-3.920	-0.159	0.235	0.641
(-3,+3)	-4.210	-0.968	0.337	0.774
(-3,-1)	-3.709	-0.376	0.292	0.620
(-2,+2)	-3.704	-1.305	0.466	0.279
(-1,+1)	-0.313	-0.900	0.507	0.196
(-1,+3)	-0.693	-1.232	0.659	0.694
(-1, 5)	-0.522	-1.079	0.687	0.239
(-1,+10)	-0.336	-12.348	0.284	0.294

***Significant at 1% level, **Significant at 5% level, *Significant at 10% level

From Table 3, it is observed that p-value for mean difference indicates statistical insignificant for all event windows of Regime #1 and Regime #2. Similarly, no statistical significance is found for p-value in the Mann-Whitney nonparametric test. The results thus, indicate that there is insignificant difference in cumulative abnormal returns at the lockup expiration between Regime #1 and Regime #2. As such, the results prove that the change in lockup regulation does not have an impact in reducing the abnormal returns at the lockup expiration.

As mentioned earlier, Bursa Malaysia consists of Main Market and ACE Market. Therefore, this study also explores the lockup expiration between these two markets. In order to confirm the statistical significance of the abnormal returns between these two markets at lockup expiration, both independent samples t-test with unequal variances and nonparametric test for independent samples using various event windows are carried out. Results of the statistical tests are tabulated in Table 4 as shown below.

Table 4: Independent sample t-test and nonparametric test for Main Market and ACE Market

Event Window	Main Market (%)	ACE Market (%)	p-value (Mean Difference)	p-value (Mann-Whitney)
(-10, +10)	-6.428	-5.940	0.947	0.446
(-10, -1)	-0.896	-5.787	0.316	0.871
(-5, +5)	-0.985	-5.899	0.335	0.227
(-5, -1)	-0.472	-5.708	0.281	0.791
(-3, +3)	-0.831	-6.181	0.297	0.815
(-3, -1)	-0.473	-5.484	0.307	0.534
(-2, +2)	-0.964	-5.416	0.375	0.173
(-1, +1)	-0.609	-0.289	0.775	0.582
(-1, +3)	-0.813	-0.832	0.990	0.433
(-1, +5)	-0.969	-0.326	0.695	0.118
(-1, 10)	-5.988	-0.287	0.300	0.423

***Significant at 1% level, **Significant at 5% level, *Significant at 10% level

From Table 4, p-value for mean difference indicates statistical insignificant for all event windows between the Main Market and the ACE Market. Similarly, no statistical significance is observed for p-value in the Mann-Whitney nonparametric test. The results therefore show that there is no significant difference in cumulative abnormal returns at the lockup expiration between the Main Market and ACE Market.

Conclusion

This study examines the share price reaction at the expiration of Malaysian IPO lockups spanning from May 2003 to December 2012. The findings are consistent with previous evidence from the US, indicating that the Malaysian equity market is an inefficient market in relation to the semi-strong form. It is attributed to the unique features of mandatory lockup provisions where the regulation is imposed on both the percentage of shares that are subjected to a lockup and the lockup length. Hence, IPO firms are not allowed to shorten or prolonged the length of the lockup period. Since this study only focuses on the first stage of expiration of lockup period, there is insignificant difference in cumulative abnormal returns at the lockup expiry between Regime #1 and Regime #2. In addition, there is also insignificant difference in cumulative abnormal returns at the lockup expiration between the Main Market and ACE Market. Therefore, future study can be extended by including the multiple lockup expiration that take place in the ACE Market. In addition, impact on trading volume and the determining factors that influencing the level of abnormal returns at lockup expiration should also be explored.

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