Chapter 1

Introduction

I. Rationale and Motivation

Initial Public Offerings (IPOs) of common stocks have been known for long time to exhibit interesting phenomena for financial research. The phenomena include high positive returns found on the first day of trading (Ibbotson (1975), Logue (1973), Ritter (1984) and Ibbotson, Sindelar and Ritter (1988)). Furthermore, researchers discover that the subsequent returns of the IPOs often display a poorer performance than their peer stocks or some relevant benchmarks (Stoll and Curly (1970), Ibbotson (1975), Ritter (1991), Loughran and Ritter (1995)). Although much has been done on these two anomalies, current studies still focus on and offers new explanations for these issues.

Among many theoretical models that attempt to explain the IPOs' anomaly, the models based on different ability of investors to acquire information are prominent (Rock (1986), Benveniste and Spindt (1986), Carter and Manaster (1990), Field (1997)). For example, Rock (1986) explains that the high returns on the first day are caused by an attempt to compensate uninformed traders who, on average, will receive the overpriced issue with greater frequency. Implied from the Rock's model, underpricing is positively correlated with proportion of informed investors. Another example, Field (1997) finds that the IPO stocks that are held by institutional investors tend to subsequently earn significantly higher long-run returns than those with smaller institutional shareholdings. Field (1997) demonstrates that institutional investors may have some ability to predict the quality of the IPO. According to the Field's hypothesis, the long-run underperformance of IPOs, the anomaly usually evidenced in stock market, is not observed in the stocks that have high level of institutional holding at the first quarter subsequent to trading. Although explanations using institutional trading can explain the anomaly very well, it is difficult to test especially in the Thai Stock Market since not enough public data are available. Therefore the progress in this field is very slow.

This study can overcome the limitation mentioned above by accessing to data of shares held by each group of investor both in the primary and secondary market. Therefore, this study can explore relationship between the various types of investor holdings and the IPO anomalies. The data of investor type in the primary market report the amount of investors' subscription and allocation of IPOs and categorize them into four groups. According to the data, investors are classified as the local individual investors, the local institutional investors, the foreign individual investors and the foreign institution investors.

In the secondary market, daily volume of trading data by each type of investor are provided by the Market Surveillance Department, the Stock Exchange of Thailand According to this data, investors are categorized as broker portfolio investors, retail customer investors, mutual fund investors and foreign investors.

Study on the performance heterogeneity among investors will contribute significantly to this market. First, it explains us about the difference in the information acquisition ability among investors whereby authorities can further use to adjust their policy concerning the information dissemination of the new issues. Second, the study demonstrates to us who are really informed investors and who are relatively less informed investors. Finally, the study indicates whether information produced by some finance specialist is reliable or not. Those issues are essential to explain because the Thai stock market is relatively small compared to many developed markets such as the U.S. And, in this market, some investors can and may influence the market more easily. Moreover, due to emerging market characteristics which have become interesting markets for foreign investors, it is also necessary to explore the trading performance of foreign investors since they are the increasingly important group of investors to this market and are often claimed as the market leader.

II. Objectives of the Study

Merton (1987) models an economy in which each investor trades only the subset of available risky assets with which he or she is familiar. French and Poterba (1991) offer a similar explanation for the seemingly small proportion of forign investments in typical American and Japanese stock portfolios: investors avoids assets regarding which they have limited information and experience. In the Thai stock market, Bailey and Jagtiani (1994) find that investor familiarity generate significant Alien Board price premium. According to these studies, information acquisition and dissemination are major determinants in explaining prices of securities. The purpose of this study is to test the difference in ability to acquire information of the newly issued stocks by various investors and to examine the effective of dissemination of information surrounding the issuing of the new stocks in the Thai stock market. Specifically, the researcher has tested the relationship between level of holding of IPOs by various investor groups and the initial returns of IPOs. Positive correlation between informed investors and initial returns is hypothesized. Further, foreign investors and institutional investors are hypothesized to have superior information relative to individual investors. In secondary market, the superior information of investor is tested by examining the relationship between the performance of IPOs in the aftermarket and the level of trading from each investor group. The hypothesis is that informed investors have superior information to uninformed investors regarding the performance of IPOs. Thus, they have the ability to select IPOs whose future performances are better than other IPOs. In the information dissemination topic, information of EPS forecast on IPO stocks disseminated by financial analyst is investigated to see the quality of forecast and to see whether or not this information has relationship with the performance of IPOs in the aftermarket.

IPO data are appropriate for distinguishing the performance heterogeneity in investor groups since they have unique features that are different from data of other firms already listed in the market. In the IPO data, prior information of the new issue firms concerning return, risk and liquidity is scarce. The consequence of scarce information in the new issues creates a considerable distinction between those who have information and those who have not (or those who have less). Given the anomalies found in the IPO studies, researchers can use it to distinguish between the two groups (informed and uninformed investors).

In this paper, emphasis is also made on the observed trading of foreign investors in the IPO stocks since they have become the dominant traders in this market and their level of trading has increased during the past decade. To illustrate, the percentage of buying from foreign traders in Thailand has increased continuously as compared to other types of investors for year 1995, 1996 and 1997. The average percentages of buying from foreign investors for these years are 28.79, 34.72 and 46.81 respectively. The increase trading of foreign investors and their impact to the Thai stock market are document in the paper of Vannasophon (1997) and Khantavit (1996).

In conclusion, the first hypothesis of this study is that institutional investors and foreign investors, if they are truly informed investors, they should participate more in the underpriced offerings This hypothesis is tested by exploring the relationship between the initial returns of IPOs and the level of subscription from different types of investors, which are individual investors, foreign investors and local institution investors. Furthermore, the superior ability to select the better performance of IPOs in the secondary market by institution and foreign investors is hypothesized and tested. Finally, the relationship between the long-run performance of IPOs and the forecast performance from analyst forecast data are examined to see whether and to what extent this information can contribute to the IPO market.

This study is organized as follows. The Second chapter reviews literature relevant to this study. Chapter Three describes data, methodology and hypotheses of the study. Chapter Four documents the results from primary market, secondary market and results of quality of forecast information. Chapter Five concludes the overall results.