INTI INTERNATIONAL UNIVERSITY

MASTER OF BUSINESS ADMINISTRATION

IPO UNDERPRICING PHENOMENON: A STUDY OF THE MONGOLIAN STOCK MARKET FROM 2003 TO 2012

FOR REFERENCE ONLY

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DECLARATION

I declare that this research project is on my own effort, except for the information which has been used by various authors that have been cited accordingly and ethically.

Davaajargal Purevsuren
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<td>IPO</td>
<td>Initial Public Offerings</td>
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<td>MAIR</td>
<td>Market Adjusted Initial Return</td>
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<td>MSE</td>
<td>Mongolian stock exchange</td>
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<td>IR</td>
<td>Initial return</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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CHAPTER ONE: INTRODUCTION

1.0 Introduction

An Initial Public Offerings (IPO) is the first sale of shares by a firm to the public investors. IPO brings benefits to the issuing firm by opening access to pool of fund for financing future growth at lower cost and to bring good publicity, which in essence may bring in more business or draw better pool of human capital. As documented in a lot of prior empirical studies globally, the offer price of IPO has been generally underpriced providing a positive abnormal initial return on the initial trading days – an initial underpricing phenomenon. This study will add to the existing IPO literature on initial underpricing anomaly investigating on the board structure role in signaling firm value which can reduce underpricing.

1.1 Background

One of the most basic financial theories is the efficient-market hypothesis. This theory states that the financial markets are efficient and that investor cannot achieve excess return with the risk and public information taking into considerations. But in many cases, several analysts have proven this theory to be wrong. One of the areas where this theory has proven not to be correct is in initial public equity offerings.

IPOs have always been subject to much discussion for investors and researchers, and therefore there is much literature describing this subject. Two areas about IPOs have been subject to intensive research; underpricing, which results in positive initial returns, and poor long-run performance 3-5 years after the IPO. Even though there has been much research, no theory has yet been identified that can explain the two phenomenon’s.

Both abnormalities are interesting to look into, and many earlier research of underpricing have analyzed both, but the fact that underpricing exist and in a large degree have been the more analyzed of the 2 abnormalities. This abnormality have been the property about IPOs that deviates most from other stocks performance and from an investors point of view the possibility of
earning an excess return is most interesting. The fact that IPOs are often underpriced could both be analyzed from the issuer view and from investors view. The investor cannot affect the degree of underpricing, but can select which IPOs to invest in. It is interesting to analyze, if investor can pick out which IPOs that is more underpriced than others, and then earn a high return. Therefore this thesis will look at underpricing from an investors view, and will analyze if there can be found properties about the IPOs, that can help investors predict the level of underpricing.

Earlier research has mostly been done on IPOs in the 80s and 90s and is focused on large stock markets. In the last couple of years there have been low IPO activity, this is due to the financial crisis. Now the economy is growing again and there are expectations of more IPOs in the next couple of years. Especially those companies than did not want to go public, while there was crisis, and investors were not optimistic. This thesis will look at IPOs done in Mongolia from 2003-2012 and see if there are properties, that can help investors pick out IPOs that are more underpriced.

1.2 Problem statement

The research will determine the study of IPO underpricing in Mongolian market. As before maintain that Mongolian IPOs are not spared from this underpricing phenomenon. According to Yong (2007), in order to Asian IPO mentions that the average initial return as Malaysian IPOs as “...Loughran et al. (1994) - 80.3% for Malaysia .... Ritter (2003) - 104.1% for Malaysia ....” (p. 254). Yong further documents that IPOs listed on Second Board (B board) which consists of smaller and less profitable firms generally underprice more than those in Main Board (A board). In fact, this contributes to usage of listing board as a proxy for firm-quality by Taufil Mohd (2007).

In the research, Mongolian IPO seems to quite good the economic outlook. However, one of the key questions for Ulaanbaatar’s investment community is how much foreign interest there will be in 2012, and whether Mongolia will stand out as a good investment option or to drag down by outside factors. Therefore,
Mongolian biggest companies are going to public on overseas which are Hong Kong, USA, Canada, and Australian stock markets. Because, there is a lack of study of underpricing IPO in Mongolian stock exchange. Therefore, they could not make profit as well in Mongolia.

The Mongolian stock exchange has its own specific characteristic. Based on the MSE has recognized the following some structures. Firstly, segmented ownership (state owned shares, legal personal shares and public trade shares); second, separated two different board which are A and B markets; third, long time interval between issuing and listing; next little managerial ownership and last, investing process is taking a long time when investors going to invest from oversea. So investors can invest in A and B listed companies that includes 20 companies under the A list and 6 companies are under B list brand. Believe that participation in upcoming IPOs at the Mongolian Stock Exchange will prove to become one of the savviest investment decisions and best ways to diversify portfolio and hedge investment risks. However, there has not study the underpricing behavior of A and B listed board in Mongolia.

In this research defined following problem statement such as there is a lack of study of underpricing IPO in Mongolian MSE and lack of study if purpose of IPO will influence extend of IPO underpricing. Therefore, there is a lack of study if underpricing of IPO is related to the sector of industry and if underpricing of IPOs board A is there different from B board
1.3 Research Questions

This study attempts to answer the research questions.

1. Is there an underpricing phenomenon in MSE over sample period of 1 to 10 years?
2. Is the underpricing of IPO related to the purpose of IPO?
3. Is the underpricing of IPO related to the sectors of market?
4. Is the underpricing of IPO in Board A different from Board B?

1.4 Research objectives

The main purpose of this research is to study the underpricing phenomenon of Mongolian IPOs. The specific objectives are:

- To investigate whether there is underpricing of IPO in Mongolia stock market.
- To examine if the underpricing related to the main purpose of the IPO.
- To examine if the underpricing is related to the different sectors of the market.
- To examine if the underpricing is related to the different board listing in the Mongolian markets.
1.5 Significance of the study

A significant proportion of IPO firms choose to include warrants in their offerings in addition to common shares in Mongolia.

This research will be important to three parties:

1. The Government of Mongolia in establishment of developed policies.

2. The outcome of this research the result from the study will be useful for the industry especially the stock market. Understanding the crucial factors in financial management will enabled managers to focus on drives.

1.6 Limitations

This study analysis conducted with secondary market performance is to a huge degree limited by the scale and activities of the Mongolian IPO market. First, it only covered the period from 2003-2012 on 26 companies, because I could not gather the necessary data for many companies. Secondly, finding might be significantly be dissimilar within the same market in different time period depending on how the general market participants approach their IPO or investment decision making and accuracy on certain factors might be dissimilar between industries. Lastly, limitation is the possibility of stock price manipulation by a particular party with sufficient resources which would cause unusual and unnatural market activity and stock price movement.
1.7 Scope of the study

The scope of this research will be limited to companies which are publicly listed in the Mongolian Stock Exchange. The public listed companies are come from numerous different industries. If share prices truly reflect the intrinsic value of the offering companies then the inherently different operating characteristic and management styles of different industry companies will also mean that their price performance (especially time of IPO) will act differently.

Subject wise, the research scope would identify the IPO influencing, how significant and how it influences companies publicly listed in Mongolian Stock Exchange (MSE).

1.8 Summary of introduction

This chapter highlights the understanding of initial public offering and on issues that are identified to be investigated upon. An initial public offerings (IPO) is the first sale of shares by a firm to the public investors. IPO brings benefits to the issuing firm by opening access to pool of fund for financing future growth at lower cost and to bring good publicity, which in essence may bring in more business or draw better pool of human capital.

Moreover, this research will determine the study of IPO underpricing in Mongolian market and it will look at IPOs and see if there are properties that can help investors pick out IPOs that are more under-priced. Understanding the crucial factors in financial management will enabled managers to focus on drives.