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EXAMINING THE EFFECT OF DECLARATION OF INITIAL PUBLIC OFFERING ON SHARE PRICE AND RETURN: EVIDENCE FROM TEHRAN STOCK EXCHANGE

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ABSTRACT

The article 44 of the constitution of Islamic Republic of Iran, as an economic reform, converts Iran's state economy to a private one. Therefore, this study seeks to examine the effect of declaration of initial public offering on share price and return in Tehran stock Exchange. To test the research hypotheses, the research has enjoyed data relating to the general indices, expected and real return during 8 weeks before and after declaration of block share offering, and abnormal returns for each company during 16 weeks around the declaration of block share offering. The Excel software is employed to study information on prices, cash dividend and declaration date of block offering during 2001-2012. Then, calculations required for share return and abnormal return rate during the week around the declaration of the selected share offering were done. After that, the average cumulative abnormal return for transferring to Eviews statistical software is computed. To check the reliability of the variables, the Augmented Dickey Fuller Test is used and Chow's break point is also employed to check the breakpoint in the estimated model. The results indicate that initial public offering can affect price and return in financial and production/service companies.

KEYWORDS

initial public offering, share price and return, abnormal return, block share offering.

INTRODUCTION

Due to the importance and increasing spread of capital market in equipping and raising individual small capital towards production activities, identifying investors' behavior and variables affecting share price has gained great importance. Thus, recognizing effective news and finding its degree of importance based on its degree of effectiveness on share price is one of the desires of investors and capital market scholars (Saleh nezhad & Ghayoor, 2010). However, accounting researchers such as Biur (1968), Kaneli (1968) and Andrass (1974) believe that information data given in decision-making process should also be used by its prediction power in addition to investment objectives (Pattarathammas *et al*, 2009). In fact, scholars and investors should be able to predict as best as possible the share price and return affected by various factors (Saleh nezhad & Ghayoor, 2010).

Generally speaking, many factors may influence share price and returns. O'Conner (2001) suggests that factors such as financial and monetary policies of the country and certain conditions of the mentioned industry have the greatest possible effect. Of course, these are factors that organizations do not have control over. Factors which are under the control of organization and the firm's condition itself have direct effect on the share price and return. Factors such as management status, paid earnings, development projects, firm's reputation and history and debt position are considered among the most effective factors (Joub, Tursoy and Gonsel, 2009).

In Iran and in line with the implementation of the policies outlined in Article 44, some parts of state sector properties have been allocated to the private sector in addition to this transfer, the important point is the way of transfer. Since a considerable portion of share (more than 3 percent to even more than 30 percent) will be offered at once (Moradi, 2007), market reaction to this block offering has drawn many experts' attention. In 2011, for example, the Telecommunication share has been widely offered in only one day. Sometimes ago, the news about possible share offering of this company has caused changes in capital market and stock exchange. Along with block offering issue, one can point to the demand and block purchasing that can influence capital market, too. For instance, the Telecommunication share (as one of the largest privatized companies) has been purchased together by Bahman investment group. However, this research aims to seek the effect of initial public offering on share price and return. Regarding the condition of capital markets in Iran and the fact that transferring ownership from state sector to private sector occurs more in this period than last years, this topic is of particular importance.

BLOCK SHARE OFFERING

Block trade: is a type of trade in which the rules relating to price limit and volume limit are not respected. According to some experts, block share offering refers to those cases where 3 percent of share is offered while some other experts state that it involves more than 6 percent of company's share. Regarding block share offering, the volume of share offered goes beyond normal condition and it usually takes place when a company is going to be transferred from state sector to private sector.

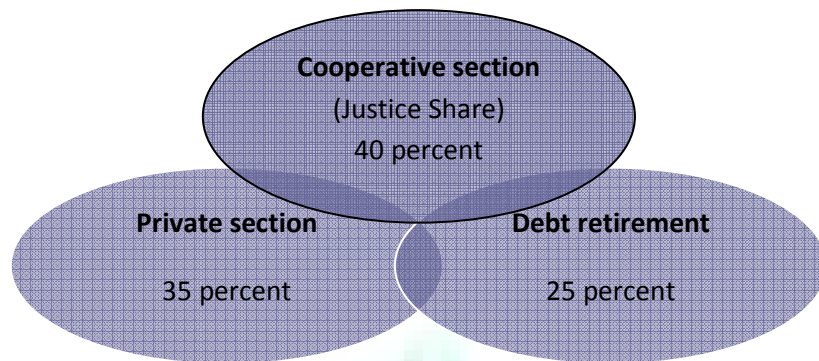
BLOCK SHARE OFFERING SITUATION IN IRAN

Considering the article 44 of the constitution of Islamic Republic of Iran and its importance, it is worth noting that Iran's economy is a state economy, and government and Supreme Leader state that implementing this article is important for country development. Implementing this economic principle has been considered as an economic reform since Imposed War.

After several years of discussion and with the aim of strengthening private sector, the government is notified to implement the article 44. Accordingly, it is believed that these quasi-state companies act better than real private sector in owning divested companies. However, economic theories and discussions necessitate economic liberalization and fewer government regulations and restrictions in the economy in exchange for greater participation of private entities and this policy is actually outlined in Note A, article 44 of the constitution and reflects the primacy of economic liberalization than privatization.

One of the major problems of the above-mentioned process is the high participation of the quasi-state companies which have purchased a large amount of divested share, especially block share, in recent years. According to the statistical observations, all divested shares are divested to the quasi-state companies based on debt retirement method. The studies show that Shosta investment company (affiliated with Social Welfare Organization), Mehr-e- Eghtesad-e-Iranian investment company (affiliated with Mehr Financial and Credit Institute) and pension funds have purchased nearly half of the total value of the divested block share.

FIGURE 1: SHARE DIVESTMENT TO VARIOUS SECTIONS SINCE ISSUING NOTE C, ARTICLE 44 OF THE CONSTITUTION



Source: Hamshahri Newspaper, Vol 19: No 5500

COLLECTING AND RECORDING COMPANIES' INFORMATION

To test the research hypotheses, the research has enjoyed data relating to the general indices, expected and real return during 8 weeks before and after declaration of block share offering, and abnormal returns for each company during 16 weeks around the declaration of block share offering. Information about block share offering, share price and other information delivered by Tehran stock Exchange is available in the official website of Tehran stock Exchange. Many financial analysts and investment companies make use of this information network to do their analysis and make appropriate decision for selling or purchasing share. The Excel software is employed to study information on prices, cash dividend and declaration date of block offering during 2001-2012. Then, calculations required for share return and abnormal return during the week around the declaration of the selected share offering were done. After that, the average cumulative abnormal return for transferring to Eviews statistical software is computed. To check the reliability of the variables, the Augmented Dickey Fuller Test is used and Chow's break point is also employed to check the breakpoint in the estimated model. The results indicate that initial public offering can affect price and return in financial and production/service companies.

TESTING THE RELIABILITY AND VALIDITY OF THE VARIABLES

Since the data using in this study is of quantitative and secondary type collected from official websites affiliated with Stock Exchange and are determined based on that organization standards, their validity is confirmed. In order to avoid false regressions, however, the reliability of the dependent and independent variables are tested. The Augmented Dickey Fuller Test is one of the most reliable tests used to examine the reliability. Therefore, the reliability of each variable is examined using Dickey-Fuller Unit Test. The results of Dickey-Fuller Unit Test are presented in Table 3. The results suggest that the number of transactions, as a variable, is reliable in the level and variables like overall index, price and cash return index, primary market index, secondary market index and financial index are reliable in the first-order difference.

TABLE 1: THE RESULTS OF DICKEY-FULLER UNIT TEST

O	Time series	ADF test-statistic	Level of significance (1%)	Collective degree
1	overall index	-11/327	0/000	I(1)
2	price and cash return index	-9/431	0/000	I(1)
3	primary market index	-6/692	0/000	I(1)
4	secondary market index	-11/504	0/000	I(1)
5	financial index	-8/099	0/000	I(1)
6	Number of transactions	-4/312	0/001	I(0)

To ensure the reliability, Im, Pesaran and Shin Test (1997) is used. According to the results of IPS test, all research variables are reliable since the P value is less than 0.05, i.e. mean and variance of the variables over time and the covariance of them between different years have remained constant. As a result, using these variables in the model would not result in false regression.

CHAW'S BREAKPOINT TEST

Since important changes occurred in the economic situation during conducting our study, especially in the mid-2005, we came to this conclusion that these changes may cause the model to make error. Therefore, the Chaw's breakpoint test is done to locate these changes. In this method, the significant level is supposed less than 1%. Consequently, the null hypothesis, the lack of break point in the 335th observation, is rejected. Thus, one can say that a breakpoint is observed in the 335th observation and the periods before and after that can be considered as two different peripheral periods.

THE RESULTS OF TESTING RESEARCH HYPOTHESES

This section tests the hypotheses in both main and two peripheral periods, the model parameters are estimated and finally the estimated model is presented. Due to the heteroscedasticity, the Garch Models are used to compute the mean equation and if heteroscedasticity is not observed, that ordinary regression model will be appropriate fit.

TABLE 2: VOLATILITY EQUATION PARAMETERS USING GARCH MODEL

		Main period 2001-2012			First peripheral period March 2001-October 2005			Second peripheral period October 2005-June 2005		
		coefficient	Z-test	Sig.	coefficient	Z-test	Sig.	coefficient	Z-test	Sig.
H1	Declaration	-0/236	-5/708	0/000	-0/296	-4/299	0/000	0/316	2/221	0/026
	Constant coefficient	-0/083	-4/837	0/000	-0/046	-1/308	0/191	3/103	3/326	0/001
H2	Declaration	-0/367	-5/746	0/000	-0/879	-4/278	0/000	0/876	2/175	0/026
	Constant coefficient	-0/094	-4/873	0/000	-0/063	-1/647	0/191	3/827	3/266	0/001
H3	Declaration	-0/135	-3/188	0/001	-0/296	-4/299	0/000	0/061	0/989	0/048
	Constant coefficient	-0/116	-5/019	0/000	-0/046	-1/308	0/032	0/069	0/727	0/032
H4	Declaration	-0/263	-3/198	0/000	-0/313	-4/299	0/000	0/057	0/976	0/000
	Constant coefficient	-0/181	-5/022	0/000	-0/053	-1/308	0/047	0/086	0/754	0/000
H5	Declaration	-0/176	-3/674	0/000	-0/237	-3/176	0/000	0/597	1/973	0/000
	Constant coefficient	-0/076	-2/345	0/000	-0/062	-1/476	0/024	2/235	2/246	0/001
H6	Declaration	-0/348	-3/457	0/000	-0/461	-3/168	0/000	0/367	2/326	0/000
	Constant coefficient	-0/072	-2/678	0/000	-0/053	-1/268	0/000	2/256	2/357	0/000

Table 2 indicates the results of estimation of Garch model for volatility equation of companies' share price in Tehran stock Exchange and findings of declaration virtual variable. As can be seen, in the main period and in declaration and constant coefficient, the volatility of share price decreases and the effect of these variables on reducing volatility is statistically significant, though reduction coefficient is more for declaration. Therefore, the first hypothesis for financial companies' share price is not rejected in the main period. In the first peripheral period, the volatility of the share price reduces and this reduction is significant in declaration, but not significant in constant coefficient. Thus, the first hypothesis is not rejected in the first peripheral period. In the second peripheral period, declaration and constant coefficient have significant effect on financial companies' share price and this effect is statistically significant for both variables. The second hypothesis, therefore, is not rejected in the second secondary hypothesis. As can be seen, other hypotheses are accepted in much the same way. In all presented results, the F test is significant at 1% level. In the periods under study, at least one of the estimated coefficients influences weekly returns. Now, let's consider the hypotheses based on ANOVA. To do so, a null hypothesis consistent with this test is formulated as follow:

$$\left\{ \begin{array}{l} H_0: \mu_1 = \mu_2 \\ H_1: \mu \neq \mu \end{array} \right.$$

The results of ANOVA are presented in the following table:

TABLE 3: ANOVA FOR SHARE PRICE

			Degree of freedom		f-statistic	Sig
H1	Between group	3279.22	99	57.2645	74.079	0/000
	Within group	4141.44	60	64.354		
H2	Between group	4801.16	62	69.2904	343.021	0/009
	Within group	1717.41	108	41.4417		
H3	Between group	4161.16	37	64.5071	231.07	0/012
	Within group	2606.29	41	51.0518		
H4	Between group	3487.31	59	59.0535	17.005	0/000
	Within group	3145.33	30	56.0833		
H5	Between group	3589.41	33	59.9117	383.098	0/009
	Within group	3544.21	37	59.5333		
H6	Between group	4863.35	33	69.7377	294.017	0/000
	Within group	4110.29	46	64.1115		

As indicated in table 3, the level of significance is less than 5% and H0 is rejected. Thus, the research hypotheses are accepted in a period between date of block share offering of the privatized financial companies and share price and return. In the following table, the acceptance - rejection status of the hypotheses is presented. As considered in the previous chapter, all six research hypotheses are accepted. In other words, initial public offering may influence different dimensions of share price and return.

TABLE 4: ACCEPTANCE-REJECTION STATUS OF THE RESEARCH HYPOTHESES

Hypotheses	Acceptance/rejected
Accepted	There is a significant relationship between the declaration date of block share offering of privatized financial companies and share price.
Accepted	There is a significant relationship between the declaration date of block share offering of privatized production companies and share price.
Accepted	There is a significant relationship between the declaration date of block share offering of privatized financial companies and normal return.
Accepted	There is a significant relationship between the declaration date of block share offering of privatized production companies and normal return.
Accepted	There is a significant relationship between the declaration date of block share offering of privatized financial companies and abnormal return.
Accepted	There is a significant relationship between the declaration date of block share offering of privatized production companies and abnormal return.

Regarding the price, although we found various effects such as price reduction and increase, the results emphasize price increase. In other words, having declared offer and considered prices in different periods till 8 weeks, the price increase was tangible. Generally speaking, the offered share price is expected to have ascending order in the course of initial public offering.

Considering the return, it is noteworthy that these effects are significant. Return partly due to price has had considerable volatility--meanwhile an ascending trend is seen. The ongoing research aims to examine the effect of informational content of block share offering declaration of privatized companies on return as well as examining the effect of block share offering declaration on share return. The result of testing this hypothesis shows a significant relationship between block share offering declaration and share return.

Using abnormal return rate is one of the most common ways of examining the informational content of declaration. The results of average cumulative abnormal return test suggest that there is a significant relationship between block offering declaration and share return. The findings of a research carried out by Ball and Brown on the relationship between earnings, abnormal return and activity volume revealed that there is a significant relationship between earnings and abnormal return, and it transfers informational earnings to the share market.

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