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Aftermarket price performance of initial public offerings on the JSA: 1980-1998

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AFTERMARKET PRICE PERFORMANCE OF INITIAL PUBLIC OFFERINGS ON THE JSE: 1980 – 1998

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A research project submitted to the Graduate School of Business Administration, University of Witswatersrand, Johannesburg, in partial fulfilment of the requirements for the Degree of Master of Business Administration.

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ABSTRACT

It is generally accepted that investors who invest in initial public offering shares on the Johannesburg Stock Exchange (JSE) expect to get returns that are in line with the risk to which they expose their investments. It would be beneficial for these investors, particularly those who invest for long periods of time, to know what returns their investments are likely to yield. It would equally be advantageous to managers of companies that intend to list on the JSE and to their advisors, to understand the critical factors that influence the performance of initial public offerings in the medium and long-term periods.

This research intended to answer three main questions regarding the performance of initial public offerings after listing. These questions were:- i) Do shares that list on the JSE yield risk-adjusted abnormal returns? ii) Are the returns received after investing in initial public offerings on the JSE dependent on the holding period of the investment? iii) Do certain characteristics of the initial public offering process influence the returns after listing? The period of study was 1980 to 1998.

Three risk-adjusted benchmarks were used to determine whether the shares that listed on the JSE yielded risk adjusted positive returns. These benchmarks were the CAPM model, the book-to-market reference portfolios and the market capitalisation reference portfolios. All three benchmarks indicated that on average, the returns yielded by the initial public offering shares were less than the risk adjusted expected returns. Furthermore, it was shown that the difference between the expected returns and the actual returns increased with the holding period of the investment. The differences were statistically significant. The research also found that certain characteristics of the initial public offering process (e.g. the listing price and the capital raised) could have influenced the returns.

DECLARATION

I declare that this project report is my own unaided work. It is being submitted to the University of the Witswatersrand in partial fulfillment of the requirements for the degree of Master of Business Administration. To my knowledge, it has not been submitted before for any degree or examination in any other university.

_____

CHAMU MARK M'KOMBE

_____ day of _____2000

DEDICATION

This project report is dedicated to my wife Maureen whose constant love and support saw me through this course.

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GLOSSARY OF TERMS

Abnormal returns	The difference between an observed share return and an expected, theoretical or ideal share return
Aftermarket returns	The difference between the closing price at the end of the period of interest and the closing price on the first day of trade
BHAR	Buy and hold abnormal returns
ß	Beta – the coefficient of systematic risk
CAPM	Capital asset pricing model – a model for the prediction of expected returns on securities as a function of the systematic risk in that security
CAR	Cumulative abnormal return
Cold listing period	A period during which the initial premia on new listings are low
Hot listing period	A period during which the initial premia on listings are high
IPO	Initial public offering
Initial return	The return from the close of the offer to the closing price on the first day of trading
JSE	Johannesburg Stock Exchange
M/B ratio	Market to book ratio
P/E multiple	Price earnings multiple
Portfolio rebalancing	A portfolio is re-balanced by selling gains on high performing shares and replenishing losses on those shares that underperformed
Premia	The amounts in excess of that period's starting price, at which shares trade in the secondary market, usually expressed as a percentage
Underpricing	Pricing of a new issue lower than the price at which it trades after listing