The short and long-run performance of Shariah-compliant IPOs on Tadawul

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Research Highlights

We examine the short- and long-run financial performance of Sharia-compliant IPO companies in Saudi Arabia for the period between 2000 and 2017. While the literature on the short-run performance is more consistent in presenting evidence of underpricing (see T. Loughran, Ritter, and Rydqvist, 1994), the evidence for long-run performance have been rather mixed and inconclusive (T. Loughran & Ritter, 1995) between under-and-over-performance outcome. Intrigued by where Saudi Arabia may be positioned on this continuum our analysis indicates that Sharia-compliant IPOs on Tadawul are underpricing with abnormal initial returns of 79.23%. For the long-run performance, our analysis indicates that investors could earn positive and significant market-adjusted BHAR of 14.67% if IPO shares were held over the eighteen-month period following the listing date using the EWI as a market benchmark. The present study would benefit foreign investors and market regulators who are trying to understand the market behaviour in an emerging market.

Research Objectives

We expanded earlier study by Mayes and Alqahtani (2015), which by doing so, update and add to the literature for the Saudi Arabia context. Our study is unique as it investigates both the short and long-run IPO performance of Shariah companies, whereas Mayes and Alqahtani (2015) only focuses on the short-run performance. The increasing attractiveness in studying the emerging markets like Saudi Arabia was due to the fact that these countries are becoming important players in the global economies (Alanazi, Liu, & Forster, 2011). Recently, the GCC have lifted the foreign investment restriction and welcomed investors from outside the region. Our findings that indicated a reduced level of underpricing, may restore investor's confidence about the Saudi market. The very high level of underpricing documented in earlier studies (see T. Loughran et al., 1994; Mayes & Alqahtani, 2015) may have created hesitancy among foreign

investors to invest in this region. High level of underpricing exacerbates market inefficiency and information asymmetry condition of a typical emerging market. Arguably, the reduced level of underpricing sends signal that the market reform initiatives by the Capital Market Authority are effective in creating stable, predictable and hopefully more transparent market exchange, which, inadvertently, attracts future investment.

Methodology(200 words)

Our final sample includes 40 and 36 companies for the short- and long-run analysis, respectively. Raw initial returns are calculated from the closing share price data on the first day of listing and the offer price for each IPO; collected from Bloomberg Professional Services (hereafter, Bloomberg). The market returns on the listing date, using the Tadawul All-Share Index (TASI) level as a proxy, were observed and subtracted from the IPOs' raw initial returns to compute the market-adjusted initial returns. To compute the 36 monthly buy-and-hold returns for the Sharia-compliant IPO companies, the monthly closing prices for each IPO were collected and compared with the monthly buy-and-hold market returns to derive the market-adjusted abnormal returns following the listing of these IPOs. We employ standard event study methodology, namely the event time approach in our analysis. We define initial returns as the returns earned by investors from purchasing the shares on the offering date, to the end of the first day of trading. The long-run post performance returns are defined as the returns earned by investors if the shares are purchased at the closing market price on the day of listing and held for 36 months, excluding the initial return period.

Results

Table 1: Raw and market-adjusted initial returns for 40 Sharia-Compliant IPOs listed on the Saudi Arabian Stock Exchange from 2004-2017

IPO	Raw Initial Returns	Market-Adjusted Returns
Mean	79.6% ^a	79.23% ^a
Standard deviation	1.995	1.991
Minimum	-58.3%	-0.58471
Median	15.7% ^b	16.71% ^b
Maximum	965.6%	963.9319%
Skewness	3.052	3.060
Kurtosis	10.573	10.607

Note:

^a Significantly different from zero at the 0.05 level, using a two-tailed test. The parametric t-test is used for means and the Wilcoxon Signed-Rank test is used for median.

Table 2: Average market-adjusted buy-and-hold returns for Sharia-compliant IPO companies

Average Market-Adjusted Buy-and-Hold Returns for Sharia-compliant IPO Companies listed on the Tadawul												
Market Indices	SAS-EWI						SAS-VWI					
	Months After the Listing of Sharia Compliance IPO Companies											
	6	12	18	24	30	36	6	12	18	24	30	36
Market-Adjusted BHARs (%)	5.53	10.49	14.67	12.38	11.95	7.50	5.73	6.93	8.91	4.32	6.30	2.41
T-Stat	1.24	1.53	1.69*	1.63	1.53	0.98	1.20	1.05	1.13	0.64	0.85	0.33

Note:

Average market-adjusted BHAR for shares within a portfolio are calculated for periods of 6, 12, 18, 24, 30 and 36 months following the listing of Sharia-compliant IPO companies on the Tadawul against the SAS-EWI and SAS-VWI benchmarks. SAS-EWI - Saudi Arabian All Shares-Equal Weight Index. SAS-VWI - Saudi Arabian All-Shares Value Weight Index.

*statistical significance at the 10% level, using a two-tailed test.

Findings

This study reports an underpricing of 79.23% for the Shariah-compliant IPOs. This study also finds overperformance in the long-run where the market-adjusted BHAR outperformed both market indices; (a) positive and significant when benchmarked against EWI; (b) positive but not significant when benchmarked against VWI. Our study corroborates earlier findings of underpricing by Mayes and Alqahtani (2015), though our level of underpricing is substantially lower, at almost one-half the amount. Similarly, the long-run IPO overperformance is rather expected from an emerging market like Saudi Arabia, that does not necessarily operate in complete symmetrical and efficient market condition (Mayes & Alqahtani, 2015).

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