

Shareholder Retention Influence on the Flipping Activity of Malaysian IPOs

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ABSTRACT

The high initial trading volume following an IPO listing is an anomaly in the aftermarket and this activity is mainly caused by the flipping activity of flippers. Therefore, this study argues that investors' interest could be one of the factors that trigger flipping activity. This study uses the signalling theory argument, whereby the proportion of shareholder retention sends a credible signal to investors and sways flipping activity. Using cross section and quantile regression in high and median quintiles, this study found a significant positive relationship between shareholder retention and flipping activity. The finding suggests that to increase the liquidity of the IPOs in the immediate aftermarket, the shareholders have to retain a higher proportion of shares in order to signal the quality and prospects of the IPOs.

Keywords: Flipping activity; IPOs; liquidity; quantile; retention; shareholder; signal; underprice

INTRODUCTION

The pattern of trading volume immediately following an IPO listing is consistently indicating an unusual behaviour. The abnormal trading activity in the IPO initial market has been so persistent both over different periods and settings that it has been accepted as another IPO anomaly. One of common reasons driving the abnormally high trading volume in the immediate aftermarket of IPOs is the investors' demand. Of particular concern is

the flippers who seem to be the main market player in matching the demand. Flipper is the term referring to the shareholders who have just been allocated with the new IPO shares. The liquidation of their IPOs in the first or first few days after listing is specifically known as flipping activity

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(Islam & Munira, 2004; Ellis, 2006; Che Yahya, Abdul-Rahim, & Yong, 2013). In other words, flipping activity is referring to the act of selling the shares which are just being subscribed by investors in the IPO immediate aftermarket. One of the reasons these flippers liquidate their newly acquired shares is to take advantage of abnormal initial returns in early aftermarket.

Previous studies that examined the anomalous of IPO under-pricing (e.g., Habib & Ljungqvist, 2001; Hiau-Abdullah & Mohd-Taufil, 2004; Abdul-Rahim & Yong, 2010; Lowry, Officer, & Schwert, 2010; Mohd Rashid, Abdul-Rahim, Hadori, & Habibi Tanha, 2013; Mohd Rashid, Abdul-Rahim, Yong, & Nor, 2013; Mohd Rashid, Abdul-Rahim, & Yong, 2014) explained that the phenomenon of underpricing is due to rational investors who are profit driven in that they rationally sell the shares when the market is offering a higher price than the offer price to gain a quick profit from the market. The sharp increase in price in the early aftermarket, which creates an opportunity for the investors to make a huge profit, will be more likely to cause the flipping activity to become high. This study acknowledges the argument that has been put forward and accordingly examines the factors that influence investors to flip their shares. In brief, the first motivation to carry out this study is that, while a few past studies (Islam & Munira, 2004; Ellis, 2006; Abdul-Rahim, Sopian, Yong, & Auzairy, 2013; Che Yahya et al., 2013) look at the behaviour of the high trading volumes in the immediate aftermarket, none of them empirically

examined the influence of insider ownership on the flipping activity. This study uses the argument by Leland and Pyle (1977) whereby insiders proportion does play an important role in signalling the firm's quality, which accordingly will trigger investors' demand and influence the immediate aftermarket trading volume substantially. In the context of this study, the role of insiders' ownership on flipping activity will be examined based on shareholder retention which reflects insiders' belief in their companies based on the proportion of shares that they willingly continue to hold despite the exit opportunity that comes with IPO.

Additionally, this study argues that the flipping activity could be detrimental to the performance of IPOs if the demand from the market is not sufficient enough to sustain the price. Therefore, this study contends that examining the factors (specifically insiders' characteristics) that influence flipping activity should be given adequate attention as the results could assist issuers and investors in making investment decisions. This study focuses on the signalling theory (Leland & Pyle, 1977) to propose that shareholder retention shall provide a credible signal to the investors. As investors' belief on the positive signal translates into a higher price at listing, a window of opportunity to make a quick profit is opened. Rational investors will tend to sell the shares, therefore creating a scenario that is conducive for flipping activity. However, no studies have been conducted to prove the relationship, other than that by Li, Zheng and Melancon (2005) which examined the influence of

shareholder retention on liquidity. Their study is still different from the one that this study is about to embark in that they focus on liquidity which is measured based on the trading volume over the first twenty days after the IPO listing. Meanwhile, the present study examines the flipping activity during the initial trading of the IPO, which is on the first day, and for the robustness test, the present study will also consider the flipping activity on the first three days as well one week after the IPO listing.

Finally, the third motivation for this study is the need for a separate study for the Malaysian IPO market because this market has unique features that may not allow investors to adopt strategies based on the findings from other markets, particularly from developed markets. Applicants for the new issues are required to assume the fixed price determined by the issuing firm and underwriters, of course finally in the discretion of the Securities Commission of Malaysia (the security market regulators). Thus, the specific regulations and listing requirements in Malaysia could influence the relationship between shareholder retention and flipping activity.

The remaining of the paper is organised in the following manner. The next section reviews the literature relevant to the study. This is followed by another section describing the data and methodology, a section on the findings, and finally, the last section provides the conclusion and implications of the study.

LITERATURE REVIEW

Research on flipping activity has mainly been conducted in the developed market (e.g., Krigman, Shaw, & Womack, 1999; Aggarwal, 2003), whereby the main focus is given to underwriter's role. Krigman et al. (1999) and Bash (2001) examined the role of flipping activity as one of the determinant factors of long-term performance. Meanwhile, Aggarwal's (2003) findings showed that institutional investors flip their shares that are considered hot IPOs. A recent study by Che-Yahya, Abdul-Rahim, and Yong (2014) examined flipping behaviour in a sample of fixed price IPOs and found that investors tend to flip IPOs that are overpriced.

In Malaysia, the study on flipping activity is still at the preliminary stage and also limited (Chong, Ali, & Ahmad, 2009; Abdul-Rahim et al., 2013; Che Yahya et al., 2013; Che-Yahya et al., 2014). For Malaysian IPOs, the determinants of flipping activity include the IPO initial returns (Abdul-Rahim et al., 2013), representative heuristic (Chong et al., 2009), institutional investors (Che-Yahya et al., 2014) and lock-up provision (Che Yahya et al., 2013). However, none of these earliest studies have focused on the influence of shareholder retention on flipping activity. The list of studies that have examined shareholder retention generally includes those by Jain and Kini (1994), Habib and Ljungqvist (2001), Bradley and Jordan (2002), Zheng and Stangeland (2007). Within the scope of

our review on the relevant literature, none of these studies exclusively examined the direct relationship between shareholder retention and flipping activity. The only study that bears a certain degree of similarity with the present one is that by Li, Xiaofan Zheng, and Melancon (2005) that examined shareholder retention with IPO liquidity in the initial IPO market (i.e., trading volume over twenty days after the IPO listing). Therefore, this study extends the work by Li et al. (2005) by examining the influence of shareholder retention on flipping activity (specifically trading volume during the first or first few days after listing) to provide another piece of important information concerning the IPO literature.

The present study uses signalling theory as a basis for arguing that there should be a significant relationship between shareholder retention and flipping activity. This is based on the argument that pre-IPO shareholders, as insiders and shareholders who must have been more informed about their companies relative to the other IPO market players, would retain a larger portion of their shares in the company if and only if they believe that the company has a good future prospect or quality. Subsequently, the shareholders' retention rate should transmit a positive signal to the market. The signal is a good future prospect that normally will commensurate a higher price on the first day of listing relative to the offer price and, therefore, a flipping activity is expected as rational investors would not miss the chance to reap the higher return. Alternatively, this high quality signal can also translate into

lower risk investment such that the risk-return trade-off theory will quickly predict a lower return for the lower risk IPO, and as such, lower flipping activity can be expected as investors perceive the IPOs as good long-term investment potential. In short, the finding of the present study contributes to the literature on IPO flipping behaviour as a compliment to other studies concerning shareholder retention (Habib & Ljungqvist, 2001; Li et al., 2005; Zheng, Ogden, & Jen, 2005).

The present study also acknowledges other variables that are found to be significant in explaining the flipping activity and some of the variables have also been found to influence the IPO performance which indirectly will influence the flipping activity. In more specific, in examining the relationship between shareholder retention rate and flipping activity, the present study controls a few variables which include excess equity capital, initial return, market condition, oversubscription ratio, risk, institutional investors' involvement, underwriter reputation and market capitalisation.

DATA AND METHODOLOGY

This study uses a sample of IPOs listed on Bursa Malaysia in the period between January 2000 and December 2012. The study period starts in 2000 to avoid the adverse effect of the 1997/98 Asian financial crisis. The sample is confined to IPOs that are offered using the fixed price mechanism. The final sample also excludes extreme outliers, REITS, financial firms due to

different reporting of the financial statement as well as firms with limited information. Data are sourced from the prospectus, DataStream and Bloomberg.

This study uses cross-sectional regression and quantile regression, as proposed by Koenker and Bassett Jr (1978), to examine the influence of shareholder retention on flipping activity. This study utilises 20th quantile, 50th quantile and 75th quantile to compare the influence of shareholder retention on flipping activity at different levels of flipping activity. This study uses a bootstrap method to estimate the standard error since the data are conditioned to heteroscedasticity. The cross section regression and quantile regression models are written below:

$$\begin{aligned}
 FLIP_i = & a + \beta_1 SHRTN_i + \beta_2 EEC_i \\
 & + \beta_3 IROPEN_i + \beta_4 RISK_i + \beta_5 CAPZ_i + \\
 & \beta_6 OSR_i + \beta_7 PRIVATE_i + \beta_8 UND_i + \\
 & \beta_9 MKTCON_i + \varepsilon_i
 \end{aligned} \quad (1)$$

Where, the dependent variable is flipping activity (*FLIP*), calculated as the ratio of trading volume on the first day (and alternatively first three days and then one week) over the number of shares distributed. *SHRTN* is shareholder retention, which is the portion of shares the pre-IPO shareholders continue to hold after the IPOs. This study also controls seven variables: *EEC* is excess equity capacity using ratio of paid-up capital to authorized capital, *IROPEN* is the percentage of the difference between IPO offer price and its opening price on the first day of listing, *RISK* is the reciprocal

of the IPO offer price, *CAPZ* is the natural log of the market capitalization, *OSR* is the oversubscription ratio, and *DPRIVATE* is the dummy variable which is equal to 1 for IPOs issued partially or totally to institutional (and few high-worth) investors and 0 otherwise. *UND* is the underwriter reputation, which is based on the rank of the underwriters determined according to the total amount of underwriting over the total underwriting amount for a particular year, and *MKTCON* is the market condition during listing, measured using the difference between EMAS price index during the listing and offer dates.

FINDINGS AND DISCUSSION

Figure 1 illustrates the relationship between shareholder retention and flipping activity at three levels or categories of retention rate (i.e. 40-60 percent, 60-80 percent and 80-100 percent). The patterns in Figure 1 suggest that there is a positive relationship between shareholder retention and flipping activity. This implies that an increase in the proportion of shareholder retention increases the investors' tendency to engage in a flipping activity. The next results (Table 1) are on the descriptive statistics, based on the three levels of shareholder retention. The findings seem to suggest that flipping activity increases monotonically with level of shareholder retention. Table 1 also shows that firms that are larger (normally those perceived to have established operating records) tend to have a higher shareholder retention.

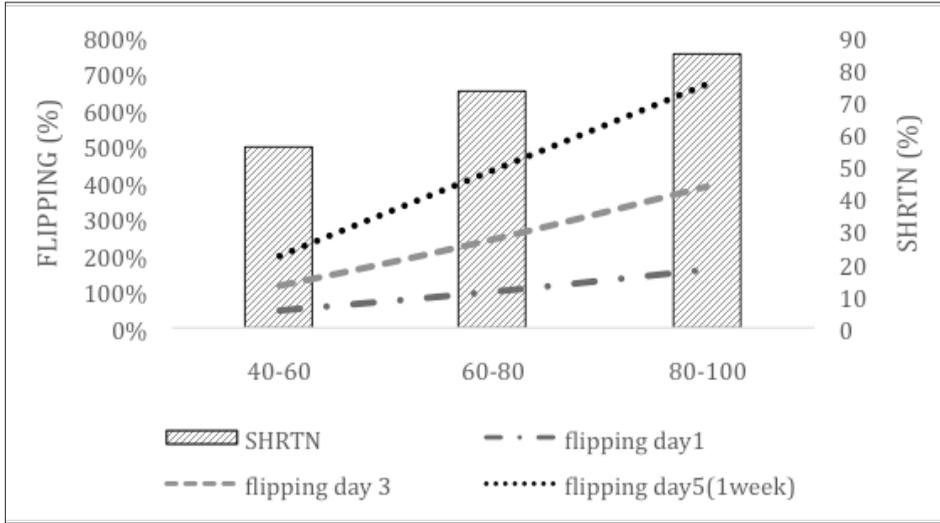


Figure 1. Shareholder retention, flipping activity on first trading day, third day and one-week using IPOs issued from January 2000 to December 2012.

The preliminary findings in Table 1 imply a condition that is consistent with the hypothesis forwarded in this study regarding the signal conveyed through shareholders' retention. Note that high

shareholders' retention is associated with large companies, implying that these IPOs are perceived as a low risk investment. This deduction is consistently supported with the lower returns for IPOs under this

Table 1
Descriptive statistics of the variables from January 2000 to December 2012

Shareholder Retention (%)	40-60% (N=93)	60-80% (N=157)	80-100% (N=84)	Whole sample (N=368)
SHRTN (%)	55.65	72.94	84.34	72.73
FLIP 1 (%)	47.61	99.51	159.83	106.18
FLIP3 (%)	68.10	145.14	228.46	153.65
FLIP5 (%)	81.71	187.65	281.61	194.76
EEC (%)	43.14	45.14	42.49	44.29
PRIVATE (%)	43.56	43.61	43.97	40.18
OFFER PRICE (RM)	0.98	0.94	1.10	1.15
IRCLOSE (%)	35.18	28.04	24.94	23.80
IROPEN (%)	33.39	31.58	23.06	22.90
OSR (Ratio)	32.99	36.12	22.19	22.62
RISK	1.71	1.71	1.72	1.41
MKT COND (%)	0.93	0.98	-0.11	-0.55
CAPZ (RM BILLION)	516.53	228.99	720.09	932.75
UNDS	7.04	8.93	7.32	8.33

category. However, what is surprising is the fact that these IPOs recorded more than 100 percent trading activity, indicating trading executed not only by flippers but existing shareholders. This contradicting results call for further investigation on the relationship between shareholder retention and flipping activity.

Note again that there is a large difference in the levels of flipping activities among different levels of shareholder retention. This calls for a further examination on the

influence of shareholder retention on flipping activity since there is no empirical evidence has been established so far. Table 2 presents the cross-section regression analysis that enumerates factors that influence the flipping activity. The regression results in Table 2 have remedied the autocorrelation problem using Newey-West procedure, while the heteroscedasticity problem in assuring that the residuals do have a constant variance is corrected using the White consistent standard errors and covariance. The overall

Table 2
OLS regression of the Shareholder Retention on the Flipping Activity

Independent Variables	FLIP1	FLIP3	FLIP5
SHRTN	2.552*** (3.239)	0.037*** (3.209)	0.046*** (3.355)
EEC	-0.276 (-0.619)	-0.005 (-0.813)	-0.006 (-0.734)
IROPEN	0.823** (2.231)	0.011** (2.300)	0.015** (2.109)
MKTCON	-2.471* (-1.670)	-0.030* (-1.820)	-0.032* (-1.786)
OSR	-0.184 (-0.898)	-0.002 (-0.796)	-0.002 (-0.667)
RISK	-21.809*** (-2.629)	-0.294*** (-2.480)	-0.398*** (-2.532)
PRIVATE	-0.204 (-0.679)	-0.001 (-0.327)	0.001 (0.250)
UND	3.410 (0.201)	0.054 (0.233)	-0.010 (-0.036)
CAPZ	-29.967*** (-4.450)	-0.432*** (-4.501)	-0.540*** (-4.484)
C	518.21*** (3.938)	7.348*** (3.916)	9.110*** (3.764)
Adjusted R-squared	0.111	0.105	0.097
F-statistic	6.104***	5.793***	5.416***
Durbin-Watson stat	1.999	2.008	2.015

model also has passed the RAMSEY misspecification test. The adjusted R2 for three models of dependent variables (i.e., flipping day 1, flipping day 3 and flipping one week) indicates that all the determinants explain 9 to 11 percent of the variations in the flipping activity. The significance of F-statistics confirms satisfactory goodness-of-fit of the models.

The regression results show that shareholder retention is positively significant in influencing flipping activity. The finding supports the signaling theory of Leland and Pyle (1977), whereby insiders do play an important role in signalling the quality of the firms. Investors believe that insiders only hold a large portion of the firm's shares if they believe in the firms' prospect and generally the shares potentially will have higher demand from investors due to higher initial return than expected. This argument further supports Brau, Lambson, and McQueen (2005), where investors who are profit-driven will normally tend to reap the abnormal return during the listing day and this behaviour will tend to increase the flipping activity due to the temptation of investors who would be allured to the higher return in the immediate aftermarket.

With regard to the control variables, excess equity capacity (*EEC*) has a negative relationship with flipping activity, yet it is not significant. The negative relationship suggests that excess equity will reduce the pressure on IPO price and lower the flipping activity by investors. Of factors that have a positive relationship with flipping, the list includes the initial return (*IROPEN*)

and underwriter reputation (*UND*). The significant positive sign of initial return suggests that investors who are profit driven will be more likely to flip their shares immediately after the IPO listing to make a quick profit from the price increase. The positive effect of underwriter reputation on flipping activity is somewhat perplexing, nonetheless it is insignificant. The result supports the prediction where firms that are established normally big firms believe to have quality and issuers tend to recruit quality underwriters in hopes of reaping the profit immediately after the IPOs listing, and it will accordingly influence the flipping activity by investors to increase.

While the other control variables such as market condition (*MKTCON*), risk (*RISK*) and market capitalisation (*CAPZ*) are negatively significant in explaining the flipping activity. The negative impact of market condition suggests that investors will hold on to their shares when the market condition is good with the hope that the price of the shares will further appreciate in the longer term. A significant negative relationship between risk and flipping activity suggests that IPOs of firms with high-risk investment could have been underpriced that the IPOs attract mass participants. Investors would hold on to the IPOs in the hope of higher compensation from the risky investments. Meanwhile, the negative significant effect of market capitalisation suggests that a bigger IPO offering will reduce flipping activity due to the large supply. Additionally, firms of bigger size are normally established firms

in terms of their operating history and they are also more transparent. Thus, due to the quality of the firms, investors may prefer holding the IPOs in the hope the market value of shares will increase further in the future. The coefficients of investors' demand (*OSR*) and institutional investors' involvement (*PRIVATE*) are also negative but they are insignificant. The finding suggests flipping activity tends to reduce when investors' demand on a particular IPO is higher. Investors seem to be more reluctant to let go off shares that are

highly demanded by other investors. Finally, institutional investors are informationally opaque that their participation in the IPOs signal a certain degree to quality such that investors are willing to hold these shares for a longer period in hope they will get some portion of the good quality pie.

The next analysis uses the quantile regression methodology in estimating the effect of shareholder retention at different levels of flipping activity. Focusing on the impact of the main variable, i.e., shareholder retention, the results show that the coefficient

Table 3
Quantile Regressions of the Shareholder Retention on the Flipping Activity

Independent Variables	FLIP1		
	25 th Quantile	50 th Quantile	75 th Quantile
SHRTN	0.176 (0.507)	1.275*** (3.079)	2.5333*** (3.692)
EEC	0.004 (0.032)	-0.065 (-0.244)	-0.300 (-0.889)
IROPEN	0.062 (0.495)	0.241 (1.356)	0.046 (0.239)
MKTCON	0.120 (0.396)	-0.130 (-0.254)	-0.046 (-0.061)
OSR	0.101 (0.961)	-0.035 (-0.176)	0.121 (0.371)
RISK	-4.231 (-1.271)	-2.552 (-0.542)	-11.887** (-1.963)
PRIVATE	-0.013 (-0.114)	-0.002 (-0.011)	0.273 (0.978)
UND	-5.078 (-1.722)	7.940 (0.806)	3.606 (0.296)
CAPZ	-5.078* (-1.722)	-11.456*** (-2.930)	-20.641*** (-4.483)
C	108.152** (2.0553)	181.976** (2.030)	337.221*** (2.829)
Pseudo R-squared	0.0229	0.058	0.079
Observations	368	368	368

Notes. ***, **, * indicate significance at 1%, 5% and 10%, respectively.

of *SHRTN* is positively significant in the 50th and 75th quantiles. This implies that the effect of shareholder retention is stronger when the flipping activity is higher. The finding is consistent with the Leland and Pyle's (1977) argument that insiders' ownership signals the quality of the IPOs.

CONCLUSION

This paper analyses the role of shareholder retention in influencing flipping activities of Malaysian IPOs. Using data from IPOs issued between 2000 and 2012, the findings suggest that the higher shareholder retention signals the quality of the IPOs, and this positive information may influence the price to further increase the tendency of rational investors to sell the IPOs in the immediate aftermarket to take advantage of the abnormally positive return during that period. In general, the findings of this study suggest that if investors are concerned with high quality investments, then the IPOs may record high flipping activities. Also, there might be certain possibilities that the value of shareholders depreciates if the selling pressure is overwhelming due to investors' decision to participate in the market to reap abnormal return during the IPO listing. Therefore, the finding of this study could be used by investors to avoid from being trapped in the value-deteriorating investments that are caused by the excessive flipping activity. The present study hopefully triggers more interests on the issue of insiders' role in predicting flipping activity. Future studies

may consider the effects of IPO market condition by segregating the study period into several sub-samples to examine the shareholder retention effect during the cold and hot market condition. In addition, other consideration such as the difference between penny and non-penny stocks on the impact of flipping activity would be a new paradigm in the IPO literature.

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