The Impact of Underwriter Reputation and Risk Factors on the Degree of Initial Public Offering Underpricing: Evidence from *Shariah*-Compliant Companies

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Abstract

IPO underpricing is an important factor used by investors to predict the profit from investment activities. Numerous empirical researches report the existence of IPO underpricing in various investment environments around the world. However, what the factors that result in such underpricing vary by country and those factors are still largely unexplored. This underpricing phenomenon is difficult to understand because various issues are related such as companies' performance, government policy and economic condition. Thus this paper investigates the average degree of IPO underpricing listed on the Malaysian Stock Exchange (MSE) using data from 476 IPOs that occurred from 2000 to 2011. MSE is a unique stock exchange because it has two types of boards which are the *shariah*-compliant board and the non *shariah*-compliant board. 89 percent of the IPO companies are listed on the *shariah*-compliant board. This paper has two objectives. Firstly, this paper investigates the average degree of IPO underpricing for *shariah*-compliant companies and non *shariah*-compliant companies. Secondly, this paper investigates the impact of underwriter reputation and risk factors on the average degree of IPO underpricing. The results show that the average degree of IPO underpricing for *shariah*-compliant companies is 28.82 percent which is quite similar to that of non *shariah*-compliant companies which is 26.63 percent. Using multiple linear regression analysis this study finds that the IPO underpricing for *shariah*-compliant companies is driven by risk factors.

Keywords: Initial Public Offering (IPO), Underpricing, *Shariah*-compliant companies, Non *shariah*-compliant companies and Malaysian Stock Exchange (MSE).

Introduction

1.1 Background

Selling shares to the general public is an important process for companies to raise capital for the expansion of business. The first instance for a company to sell its shares to the general public on a stock exchange is known as an Initial Public Offering (IPO). According to Taufil Mohd (2004), underpricing refers to the initial return that an investor earns if he buys shares of the IPO at the offer price and sells it at the end of the listing day at the market price. Hutagaol (2005) underpricing refers to the significance increase of the IPO market price over the first few days after the initial listing. Murugesu and Santhapparaj (2009) underpricing refers to the situation where a private company seeking to list its shares on stock exchange at a discount price relative to its true value. This situation makes investors earn a negative return if they were to immediately sell their shares once trading commences.

IPO underpricing is a common phenomenon for stock markets around the world. Studies from Boulton, *et al.*, (2012); Banerjee, *et al.*, (2010); Nguema and Sentis (2006); Agathee, *et al.,* (2012); Darmadi and Gunawan, (2012); Islam, *et al*, (2010); Samarakoon, (2010); Borges, (2007); Pande and Vaidyanathan, (2007); Chi and Padgett, (2005); Ekkayokkaya and Pengniti, (2012); Yamamoto, (2009)) confirmed the existing of underpricing during initial stock exchange trading. However, the factor that influences IPO underpricing varies across countries and that variation still remains largely unexplored.

The MSE is a unique stock exchange in that it has two types of boards which are *shariah*-compliant board and non *shariah*-compliant board that operate concurrently. At the end of 2011, 89 percent of IPO companies were listed on the *shariah*-compliant board (List of *Shariah*-Compliant Securities, 25 November 2011). *Shariah*-compliant companies have become important participant in the global capital market. This phenomenon was due to the awareness and demand from Muslim people in Malaysia and around the world to participate in the capital market. IPOs for *shariah*-compliant companies have also gathered significant attention in attracting non-Muslim companies and investors to participate. Thus, this paper provides preliminary research on IPO underpricing for *shariah*-compliant companies and non *shariah*-compliant companies listed on the MSE to address two issues. The first issue is whether the average degree of IPO underpricing for *shariah*-compliant companies is higher than non *shariah*-compliant companies. The second issue is associated with the growth of *shariah*-compliant companies in Malaysia. Specifically, this study is different from previous studies regarding IPO underpricing in the Malaysian market. This study investigates the *shariah*-compliant companies with specific emphasis on the impact of underwriter reputation and risk factors on the average degree of IPO underpricing for *shariah*-compliant companies. Underwriters are important in the marketing of IPO shares. When companies seek to make IPOs on the stock exchange, they will choose underwriters who can give good services for marketing IPO shares. An underwriter also plays an important role in determining the offer price and creates a good relationship between issuers and prospective investors during the IPO process. This relationship can attract the investors to buy IPO shares. A study from Carter *et al.* (2010) finds that IPOs marketed by more reputable underwriters are better than those marketed by less reputable ones. A study from Paudyal *et al.* (1998) regarding underwriter reputation in the Malaysian market found that IPOs underwritten by reputable underwriters are better long term investments as compared to the IPOs underwritten by less reputable ones.

1.2 Fundamental Prohibited Elements in Islamic Finance

Shariah-compliant companies are different from non *shariah*-compliant companies. The main features of *shariah*-compliant companies are that their activities are guided by *shariah* injunctions. IPOs for *shariah*-compliant companies must represent an assertion of religious law where the market should be prohibited from elements such as *riba*, *gharar* and *maysir*.

Prohibition of *Riba*

Riba literally means excess and increase. Technically, *riba* is defines as an increase in any exchange or sale of product or by virtue of loan without providing equivalent value to another party.

Prohibition of *Gharar*

Gharar literally implies risk, uncertainty and hazard. Technically, *gharar* is sales in which the vendor is not in a position to hand over the subject matter to the buyer, whether the subject matter is in existence or not. A contemporary scholar, Sheikh Wahbah Al-Zahaily defined *gharar* in the following term: “A contract which contains a risk to any one of the parties which could lead to his loss of properties.” (Islamic Financial System: Principles & Operations, pp.181)

Prohibition of *Maysir*

Gambling (*maysir*) is defined as any activity which involves betting. The winner will take the entire bet and the loser will lose his bet. It means games of pure chance where any party might gain at the expense of the loss of the other party.

1.3 Overview of the IPO Process in Malaysia

The Malaysian Stock Exchange (MSE) was incorporated on 14 December 1976. It has two types of markets which are the main market and the ACE market. The main market was established for companies with a profitable track record for three to five full financial years. ACE was established for high growth and technology companies in order to raise capital. The MSE was provided with two types of boards known as the *shariah*-compliant board and the non *shariah*-compliant board.

The Securities Commission (SC) of Malaysia was established on March 1, 1993. The SC is a self-funding statutory body with focus on capital market regulation in Malaysia. The roles of the SC are to regulate, supervise and systematically develop Malaysia’s capital market. In January 1996, the SC liberalized a new method of IPO shares issue on the Malaysian market that is based on a market-based pricing mechanism. The market-based pricing mechanism gave responsibilities to issuers and advisers for setting or making decisions regarding IPO price. Final approval from the SC is still required to ensure appropriateness (How *et al*., 2007; Abdul Rahim and Yong, 2010). The SC of Malaysia is also leading the development of the Malaysian Islamic capital market established by the Shariah Advisory Council (SAC). The roles of the SAC are to screen or review the companies or stocks in order to ensure fulfillment of the *shariah* requirements for listing shares on the *shariah*-compliant board. Table 1 below explains the IPO listing process on the MSE. These processes are applied to both boards: *shariah*-compliant and non *shariah*-compliant.

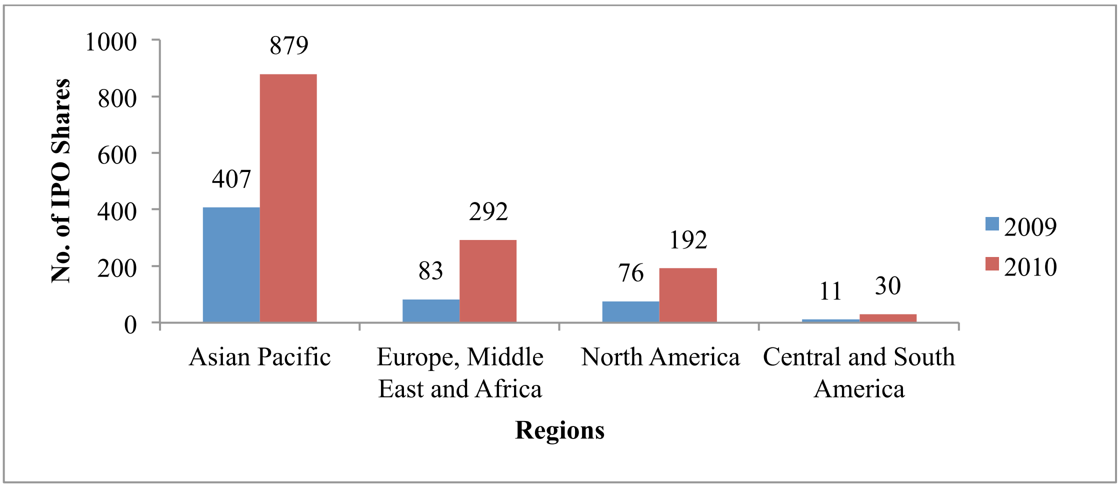
Table 1: IPO Listing Process

No.	Steps	Explanation
1	Appointment of an underwriter	The underwriters are responsible for making submissions of corporate prospectus to SC of Malaysia and MSE.
2	Implementing organizational changes	The underwriters will assess IPO companies' positions in view of listing exercises, such as corporate structure, composition of boards of directors, corporate governance, and internal controls frameworks.
3	Appointing independent directors	All IPO companies are mandated to appoint independent directors so that at least two independent directors or one-third of the members of the board are independent, whichever is higher. An independent director is one who is independent of management and free from any business or other relationship, which could interfere with the exercise of independent judgment or the ability to act in the best interest of a listed company. (Good Governance Guide, No. 5.1)
4	Method of listing and valuation	IPO companies and underwriters need to decide on the method for offering their IPO shares and make valuation of IPO companies based on past earnings in order to forecast the future earnings.
5	Preparing documents for submission	IPO companies and underwriter must prepare a prospectus for submission to the MSE and SC of Malaysia.
6	Submission and review	The review of the application for listing begins after submission of the application document. The prospectus will go through a public exposure period on the SC of Malaysia website for a period 15 market days for public feedback.
7	Approval	After MSE and SC approve the application for listing, they will issue a letter of approval for IPO shares and a letter of approval-in-principle for the prospectus registration.
8	Registration of the prospectus	After receiving on approval letter, IPO companies must register on the MSE.
9	Investor briefings	The offer period begins when the prospectus is issued to the public. During this time, IPO companies need to start a briefing campaign to investors. Briefing campaign activities can include road shows and presentations to investors by the company's directors and promoters.
10	Balloting process	After investor briefings, the balloting of the applications will commence.
11	Listing	The IPO listing process ends by a listing ceremony on the MSE and the trading of IPO shares will commerce on this day.

1.4 IPO Shares Issues

Graph 1 shows the IPO shares issued worldwide. The graph indicates an increase of IPO shares issued from 2009 (577 IPOs) to 2010 (1393 IPOs). The Central and South America area's countries have the lowest issue of IPO shares.

Graph 1: IPO Shares Issues around the World

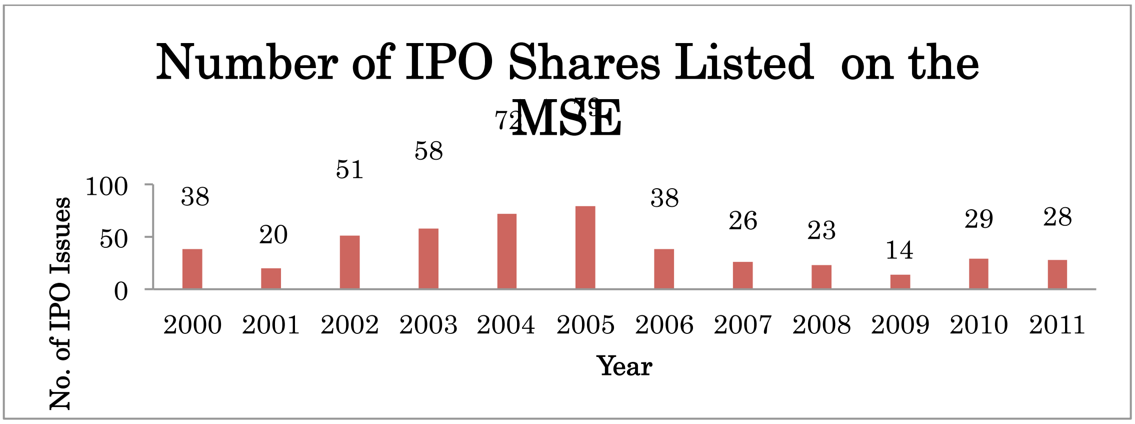


Source: Global IPOs Trend 2011 Report

1.5 IPO Shares Issues in Malaysia

Graph 2 shows the number of IPO share issues in Malaysia from 2000 to 2011. The highest number of IPO share issues occurred in 2005 (79 IPOs) and the lowest number of IPO shares issues occurred in 2009 (14 IPOs). A possible explanation of the low number of IPO issues in 2009 is the sub-prime crisis that happened from 2007 to 2009. This crisis had a negative impact on the issuance of IPO shares in the MSE.

Graph 2: IPO Issues in Malaysia from 2000-2011



Source: Malaysia Stock Exchange

Table 2 shows the *shariah*-compliant companies and non *shariah*-compliant companies listed on the MSE. 420 IPO shares are from *shariah*-compliant companies while 56 are from non *shariah*-compliant companies. It is essential to differentiate *shariah*-compliant companies from non *shariah*-compliant companies because of their different regulatory guidelines. This also helps Muslim investors to differentiate *shariah*-compliant companies from non *shariah*-compliant companies.

Table 2: Number of IPO Shares Issues for *Shariah*-compliant and Non *Shariah*-compliant Companies

Year	*Shariah*-compliant	Non *shariah*-sompliant
2000	36	2
2001	20	0
2002	48	3
2003	48	10
2004	60	12
2005	70	9
2006	35	3
2007	22	4
2008	22	1
2009	13	1
2010	23	6
2011	23	5
Total	**420**	**56**

Source: Malaysian Stock Exchange (MSE)

1.6 IPO Shares Issues by Types of Industry Listed on the MSE

Table 3 shows IPO share issues by type of industry listed on the MSE from 2000 to 2011. The highest number of IPO shares issues are from companies engaged in industrial production (134 IPOs) followed by the trading and service industry (105 IPOs). The technology industry (99 IPOs) has the third highest number of industry IPO share issues. The lowest numbers of IPO share issues are the Closed and Fund industry (1 IPO) and Special-Purpose Allocation Company industry (1 IPO).

Table 3: Number of IPO Shares Issue in Malaysia from 2000 to 2011 by Type of Industries

Industries	Total (Year 2000-2011)	Percentage (%)
Industrial Products	134	28.15%
Trading/Services	105	22.06%
Technology	99	20.80%
Consumer Product	73	15.34%
Property	19	3.99%
Real Estate Investment Trusts (REITs)	13	2.73%
Construction	11	2.31%
Plantation	9	1.89%
Finance	7	1.47%
Infrastructure Project Cos.	4	0.84%
Close/Fund	1	0.21%
Special Purpose Allocation Company	1	0.21%
TOTAL	**476**	**100.00%**

Literature review

2.1 IPO Underpricing

In almost every country, IPOs are underpriced. A study by Islam, Ali, and Ahmad (2010) reports a very high average degree of IPO underpricing in Bangladesh (480.72 percent) for the period 1995 to 2005. In the People's Republic of China, IPO underpricing of 129.16 percent, for the period 1996 to 2000, was reported by Chi and Padgett (2005).

Malaysia has also reported a high average degree of IPO underpricing. The most significant study that measures IPO underpricing in Malaysia is Dowson (1987). IPO data collected from 1978 to 1984 show that IPOs in Malaysia are underpriced at 166.7 percent, compared with Hong Kong's 13.8 percent and Singapore's 39.4 percent. Jelic *et al.* (2001) found that the average presence of IPO underpricing is 99 percent during the period 1980 to 1995. The study from Yong and Isa (2003) found that the average occurrence of IPO underpricing is 94.91 percent over the entire January 1990 to December 1998 period. Murugesu and Santhapparaj (2009) found that IPOs are underpriced at 81 percent from 1999 to 2004. The previous studies regarding IPO underpricing in the Malaysian market reported that the average degree of IPO underpricing is high if compared with the other mature stock markets around the world. This underpricing phenomenon happened in most stock exchanges around the world. Table 4 shows the average degree of IPO underpricing around the world. The highest IPO underpricing is reported in Bangladesh and the lowest in Portugal.

Table 4: Summarizing of IPO Underpricing Around the World

Countries/Region	Period of Study	Average degree of IPO underpricing	Authors
Bangladesh	1995-2005	480.72%	Islam, Ali and Ahmad (2010)
Middle East and North Africa	January 2000-July 2007	184.1%	Chahine and Tohmé (2009)
P.R. of China	1996-2000	129.16%	Chi and Padgett (2005)
Japan	2001-2006	60.21%	Uzaki (2009)
Sri Lanka	1987-2008	34%	Samarakoon (2010)
Thailand	1990-2007	22.99%	Ekkayokkaya and Pengniti (2011)
India	2004-2006	22.62%	Pande and Vaidyanathan (2007)
Indonesia	2003-2011	22.2%	Darmadi and Gunawan (2012)
Singapore	1993-2005	16.5%	Zhang, C. and King, T.H.D. (2008)
Mauritius	1989-2010	13.14%	Agathee, Sannasse and Brooks (2012)
Portugal	1988-2004	11.1%	Borges (2007)

2.2 Underwriter Reputation

Premarket activities undertaken by the underwriter can signal to the public the significant demand for the IPO shares. Most empirical studies find a significant relationship between underwriter reputation and the average degree of IPO underpricing. It shows that an underwriter plays a significant role in determining IPO underpricing performance.

An empirical study conducted by Carter *et al.* (1998) suggested that the underperformance of IPO stocks relative to the market over a three-year holding period is less severe for IPOs handled by more reputable underwriters. Yip *et al.* (2009) found that investors can earn above-market returns by investing in IPOs that are underwritten by leading investment banks and backed by venture capitalists and divest before the expiration of the lockup period. Kirkulak and Davis (2005) investigate underwriter reputation and IPO underpricing for the Japanese IPO market. They find that the relationship between underwriter reputation and IPO underpricing depends on when the IPO is priced, reflecting the level of demand for the issue.

A study from Jones and Swaleheen (2010) show that the underwriter reputation is statistically negatively related to initial return from 1980 to 1991 and statistically positively related to initial returns from 1992 to 2003 in the USA, when underwriter reputation is taken as an exogenous variable. An empirical study from Kenourgios *et al.* (2007) show that underwriter reputation and times of oversubscription significantly affect the average degree of IPO underpricing in Greece.

A study from Neupane and Thapa (2013) regarding underwriter reputation and the underwriter-investor relationship in IPO markets in India found that high reputation and low reputation underwriters have strong relationships with different sets of investors. While large institutional investors participate early in IPOs managed by high reputation underwriters, high net worth investors appear to do the same in IPOs managed by low reputation underwriters. The varying nature of relationships with investors also has important consequences for IPO pricing. The analysis of setting the offer price shows that reputation matters greatly for high reputation underwriters. Low reputation underwriters, on the other hand, appear to price aggressively and set high offer prices even when institutional participation is negligible.

Results from a study by Jelic *et al.* (2001) do not provide evidence that offers underwritten by more prestigious underwriters are better long-term investments as compared to those underwritten by less prestigious underwriters in the Malaysian market.

2.3 Risk Factors

Risk factors involved in evaluating the average degree of IPO underpricing is important in estimating the return to investors. A study by Nguema and Sentis (2006) on 33 countries around the world found that country risk is one of the determining factors of IPO underpricing. Sahoo and Rajib (2011) found that risk and uncertainty have a significant impact on the average degree of IPO underpricing. This study used a sample of 171 IPOs issued in India during the period 2002 to 2007. Agathee *et al.* (2012) examined evidence on the short-term underpricing of IPO shares listed on the Stock Exchange of Mauritius from 1989 to 2010. The average initial return is 13.14%. Using regression analysis, they found that aftermarket risk level and auditor's reputation has a significant positive impact on the average degree of IPO underpricing.

Research methodology

3.1 Sample

The data used in this study is comprised of 420 IPOs for *shariah*-compliant companies and 56 IPOs for non *shariah*-compliant companies from 2000 to 2011. The data from this study are compiled from the Malaysian Stock Exchange, Prospectuses, the ISI Emerging Market website and listed company websites.

3.2 Data Analysis

To calculate the average degree of IPO underpricing for *shariah*-compliant companies and non *shariah*-compliant companies on the first day trading on the MSE, this study calculated underpricing using the following formula:

$$\boldsymbol{UP_i = \frac{CP_i - OF_i}{OF_i}}$$

Where,
UP_i: underpricing in firm i
CP_i: closing price in firm i
OF_i: offering price in firm i

To quantify the impact of the two explanatory variables on the average rate of IPO underpricing for *shariah*-compliant companies, this study performs a multiple linear regression using the following equation:

$$\boldsymbol{UP_i = \alpha_i + \beta_1 (UR_i) + \beta_2 (R_i) + \varepsilon_i}$$

Where,
UP: underpricing
UR: underwriter reputation
R: risk factors
ε: other factors

Table 5 explains the predictor variables used in this study. The main hypotheses that are tested in this study are underwriter reputation and risk factors. Investors can get good information regarding IPO companies from underwriters during the briefing process. Underwriters play an important role in attracting potential investors. The important factors in investment are risk and return. Risk can be defined as uncertainty of returns that investors earn during the investment process. If the offer price is below the market price, it generated negative return to investors. The main objective of investment is to maximize return and minimize a risk.

Table 5: Explanation of Determinants of IPO Underpricing for *Shariah*-Compliant Companies

Explanatory Variable	**Description**
UR= Underwriter reputation (dummy variable)	High underwriter reputation: The first and second highest number of IPOs managed by an underwriter during a period of study.
R= Risks factor	Using a method from Abdul Rahim and Yong (2010) this study calculated risk as the reciprocal of the IPO offer price, that is: $risk = \frac{1}{OF_i}$ Where, OF= offering price

The following hypotheses are proposed:

H_0= Underwriter reputation and risk factors individually have no significant effect on the average degree of IPO underpricing for *shariah*-compliant companies.

H_1= Underwriter reputation has a significant effect on the average degree of IPO underpricing for *shariah*-compliant companies.
H_2= Risk factors have a significant effect on the average degree of IPO underpricing for *shariah*-compliant companies.

Results

4.1 Average Degree of IPO Underpricing

In this section, the results are presented in two stages. The first stage is descriptive statistics of the average degree of IPO underpricing for *shariah*-compliant companies and non *shariah*-compliant companies. The results also report the average degree of IPO underpricing for types of industry, for high and low underwriter reputation, and for *shariah*-compliant and non *shariah*-compliant companies. The second stage presents the results of the multiple linear regression analysis on the effect of both underwriter reputation and risk factors on the average degree of IPO underpricing for *shariah*-compliant companies listed on the MSE.

Table 6 shows the descriptive statistics results on the average degree of IPO underpricing for *shariah*-compliant companies and non *shariah*-compliant companies. The average degree of IPO underpricing for *shariah*-compliant companies is 28.82 percent and 26.63 percent for non *shariah*-compliant companies. Therefore, the average degree of IPO underpricing in Malaysia is lower than reported by previous studies. For example, Dawson (1987) report average degree of IPO underpricing at 166.7 percent; Jelic *et al.* (2001), 99 percent; Yong and Isa (2003), 94.91 percent; and Murugesu and Santhanpparaj (2009), 81 percent. This result also suggests that the average degree of IPO underpricing for *shariah*-compliant companies is quite similar with that of non *shariah*-compliant companies. A possible explanation of the decrease in the average degree of IPO underpricing reported in this study is related to the market-based pricing mechanism introduced by the Securities Commission (SC) in 1996. This method is applied for *shariah*-compliant companies and non *shariah*-compliant companies.

Table 6: Average Degree of IPO Underpricing

Company	No. of Companies	Underpricing	Minimum	Maximum	Standard Deviation
Shariah-compliant companies	420	28.82%	-0.45	2.64	0.4551
Non *Shariah*-compliant companies	56	26.63%	-0.25	2.62	0.5546

Table 7 shows the average degree of IPO underpricing by types of industry. The results from *shariah*-compliant companies show that IPOs are overpriced for infrastructure (-4.12 percent) and finance (-9.60 percent). In contrast, construction (12 percent) and Special Purpose Allocation Company (15 percent) industries are overpriced for non *shariah*-compliant companies. Technology industries (-51.78 percent) tend to have a higher average degree of IPO underpricing for non *shariah*-compliant companies compared with *shariah*-compliant companies (-37.71 percent). These results show that technology is a more risky industry for investment due to its high average degree of IPO underpricing.

Table 7: Comparison of Average Degree of IPO Underpricing for *Shariah*-compliant Companies and Non *Shariah*-compliant Companies by Types of Industry

Types of Industry	***Shariah*-compliant Companies**		**Non *shariah*-compliant Companies**	
	No. of Companies	**Average Degree of IPO Underpricing**	**No. of Companies**	**Average Degree of IPO Underpricing**
Industry product	127	27.26%	7	34.43%
Trading/service	90	30.87%	15	44.53%
Technology	90	37.71%	9	51.78%
Consumer product	70	26.16%	3	4.33%
Property	17	12.11%	2	-7%
Construction	10	28.63%	1	-12%
Plantation	8	15.08%	1	27%
Infrastructure	4	-4.12%	-	-
Real estate investment trust (REITs)	3	17.07%	10	3.6%
Finance	1	-9.60%	6	13.33%
Special Purpose Allocation Company (SPAC)	-	-	1	-15%
Close/Fund	-	-	1	1%

Table 8 shows the average degree of IPO underpricing for *shariah*-complaint companies for high and low underwriter reputations. The results show that the *shariah*-compliant companies led by high-reputation underwriters tend to be underpriced lower (-25.04 percent) compared with *shariah*-compliant companies lead by low-reputation underwriter (-31.68 percent). This finding suggests that IPO for *shariah*-compliant companies managed by high underwriter reputations can decrease the average degree of IPO underpricing. It also suggests that the pre-market service provided by high underwriter reputation, such as road show activities and offer price adjustment, can affect the average degree of IPO underpricing. The results from non *shariah*-compliant companies are different from *shariah*-compliant companies. The average degree of IPO underpricing for high underwriter reputation is 36.08 percent, and that for low underwriter reputation is 17.83 percent. This result shows that IPO for non *shariah*-compliant companies managed by high or low underwriter reputation does not have any impact on the average degree of IPO underpricing.

Table 8: Average Degree of IPO Underpricing for *Shariah*-compliant Companies for High and Low Underwriter Reputation

Underwriter reputation	No of Companies	Underpricing	Minimum	Maximum	Standard Deviation
Shariah-compliant Companies:					
1. High underwriter reputation	181	25.04%	-0.39	1.80	0.36927
2. Low underwriter reputation	239	31.68%	-0.45	2.64	0.50942
Non *Shariah*-compliant Companies:					
1. High underwriter reputation	27	36.08%	-0.25	2.62	0.64034
2. Low underwriter reputation	29	17.83%	-0.20	1.84	0.45466

Table 9 presents the results of the multiple linear regression estimation. While the risks variable is statistically significant at 0.01 level of significance, underwriter reputation is found to be insignificant. This finding contrasts with several studies on underwriter reputation. The study from Kirkulak and Davis (2005) regarding underwriter reputation in the Japanese IPO market found a significant relationship between underwriter reputation and average degree of IPO underpricing. Jones and Swaleheen (2010) examine the underwriter reputation in the USA from 1980 to 2003. They found that underwriter reputation has a statistically positive significant impact on the average degree of IPO underpricing during the period 1992 to 2003 when underwriter reputation is taken as an exogenous variable. When considering the choice of the high or low reputation underwriter as endogenous to characteristics of the firm, underwriter reputation has a significant positive impact on the average degree of IPO underpricing (for the period 1980 to 2003 and 1992 to 2003) and it has an insignificant impact for the period 1980 to 1991.

Table 9: Results of Multiple Linear Regression Analysis

Variable	Coefficient	t-statistics
Intercept	0.198	(4.430)
Underwriter reputation	-0.029	(-0.638)
Risk	0.066	(3.513)*
	R square = 3.4%	
	F value = 7.302	
	Durbin Watson = 1.664	

* Indicates statistical significance at the 1% level

Conclusion

This paper examines the profiles of IPO underpricing for *shariah*-compliant companies listed on the MSE. This is done by investigating the average degree of IPO underpricing for *shariah*-compliant companies from 2000 to 2011. Overall, this study uses 420 IPOs for *shariah*-compliant companies and 56 IPOs for non *shariah*-compliant companies issued during the period of study. Even though there are many empirical studies regarding IPO underpricing in Malaysia, there are no previous studies that look at the effects of underwriter reputation and risk factors on the average degree of IPO underpricing for *shariah*-compliant companies. This study endeavors to fill this gap.

The preliminary results show that the average degree of IPO underpricing for *shariah*-complaint companies is 28.82 percent and 26.63 percent for non *shariah*-complaint companies. Compared to the average degree of IPO underpricing of 166.7 percent (Dowson, 1987), 99 percent (Jelic *et al.*, 2001), 94.91 percent (Yong and Isa, 2003) and 81 percent (Murugesu and Santhanpparaj, 2009), the average degree of IPO underpricing reported in this study is more similar to those in mature markets. One possible reason that explains the lower percentage of IPO underpricing is revisions of the IPO pricing mechanism by the Securities Commission of Malaysia. This finding is similar to the findings reported in Japan. Pettway and Kaneko (1996) found that removed price limits and introduced public auctions reduced the average degree of IPO underpricing significantly.

Secondly, the results from *shariah*-compliant companies show that IPOs are overpriced for the infrastructure industry (4.12 percent) and the finance industry (9.60 percent). In contrast, construction (12 percent) and Special Purpose Allocation Company (SPAC) (15 percent) industries are overpriced for non *shariah*-compliant companies. Technology industry companies (-51.78 percent) tend to have the highest average degree of IPO underpricing for non *shariah*-compliant companies compared with *shariah*-compliant companies (-37.71 percent). This result suggests that the technology industry is risky industry for investment due to the high average degree of IPO underpricing. The average degree of IPO underpricing for *shariah*-compliant companies led by high underwriter reputation tends to be less underpriced (-25.04 percent) compared with *shariah*-compliant companies led by low underwriter reputation (-31.68 percent). This result suggests that underwriter reputation plays an important role in determining the average degree of IPO underpricing for *shariah*-compliant companies in Malaysia. However, the results from non *shariah*-compliant companies contrast with those from *shariah*-compliant companies. The average degree of IPO underpricing for high underwriter reputation is 36.08 percent, and that for low underwriter reputation is 17.83 percent. This result shows that IPO for non *shariah*-compliant managed by high or low underwriter reputation does not give any impact on the average degree of IPO underpricing.

Finally, the results of the multiple linear regression estimation indicate that IPO underpricing issues by *shariah*-compliant companies are driven by the risk factors. This result is similar to the finding from Sahoo and Rajib (2011) regarding the impact of risk proxies on the average degree of IPO underpricing in India. They found that risk and uncertainty surrounding IPOs have a significant impact on the average degree of IPO underpricing. A possible explanation is the implementation of the new pricing methods in the Malaysian market. When the IPO companies and underwriters have responsibility in setting offer prices, they try to set suitable offer prices for presumed market prices. This reduces the risk for loss during the initial trading on the stock exchange.

Further research could seek to enlarge the potential determining factors that could be influencing the average degree of IPO underpricing. In addition, the role of regulatory agencies in the Malaysian capital market could be more closely examined, especially in relation to short-term and long-term price performance.

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