Title

Volatility of Early Returns of Initial Public Offerings (IPOs) and the Influence of Corporate Fraud

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By

Alex Augustus Ambore BRUCE

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Certificate in Computer Application

Advance Certificate in Econometrics using E-Views Software

Dip. In Business Administration

BSc. (Hons.) Business Administration (Banking and Finance)

Master of Science in Finance

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Abstract

Early Returns of Initial Public Offerings (IPOs) face unwarranted bubbles and crashes which are associated with the price of the IPO stocks and are believed to be product of macroeconomic and firm-specific variables that act within and outside the circumference of the issuing firm. Thus, the researcher is poised to tackle two questions; (1) what are the causes and degree of volatility of IPOs initial returns in Nigeria and Sri Lanka; and (2) can perceived corporate fraud tendency (i.e. under-pricing/overpricing) during and after the IPOs constitute a factor for IPOs initial returns volatility? IPOs initial returns is used as a function of Exchange, inflation, interest, broad money supply, price of other stocks, dividend per share, volume rates and the fraud tendency variables. The Ordinary Least Square is invoked along with advance methodological approach such as the Vector Autoregression and Generalized Autoregressive Conditional Heteroskedasticity models to capture the returns volatility, stylized facts and shocks on the IPOs initial returns. The study make use of 158 and 139 equity IPOs from 1987-2012 and 1988-2012 for the Nigerian Stock Exchange (NSE) and Colombo Stock Exchange (CSE), respectively, for the first-day observation, while 5,452 & 4,944 and 469 & 385 satisfy for the monthly and yearly observations, respectively. The results are robust and show substantial impact of the variables on IPOs initial return volatility in both markets given rise to very persistent degree of volatility clustering of 132% and 141% in the first-day for the NSE and CSE, respectively. On monthly result, the NSE tend to experience 75% volatility with leverage effect of 20% and average returns of 205.78% and fraud volatility clustering of 245.5% indicating lower volatility compared to first-day; while in the CSE, volatility increase during the month to 307.82% with lower average initial returns of 65.64% and fraud volatility of 151.35%. The result also show that the yearly volatility rate in the NSE amounts to 128.48% with average initial return of 17.84% and fraud leverage effect of 34.59%. Likewise the situation in the CSE also behaves like the first-day with volatility of 5.44% and average returns of 147.22%. The result is consistent with the conceptual framework formulated and establishes that the initial returns of IPOs in the emerging markets of Nigeria and Sri Lanka suffer from the effect of macroeconomic, firm-specific and corporate fraud variables, thereby increasing the IPO stocks returns volatility. However, inflation rate, interest rate, exchange rate, broad money supply, under-pricing and overpricing have more impacting and generally determines the volatility rate of IPOs initial returns than the other factors such as price of other stocks, volumes ratio and dividend per share.

Key Words: IPOs, Volatility, Returns, NSE, CSE, Corporate Fraud, and Macroeconomic variables.