

**THE OPTIMAL OFFER MECHANISM FOR CONTROLLING
UNDERPRICING OF IPOs IN PAKISTANI CAPITAL MARKET**

By

ASAD ULLAH

A thesis presented to Bahria University, Islamabad in partial fulfillment of the
requirements for the degree of Master of Philosophy



May 2014

ACKNOWLEDGEMENTS

All praises to Allah who enabled me to undertake and complete this dissertation. He has blessed me with the company of people who are unique in their own way and have been of immense help to me throughout this dissertation. First of all, I would like to extend my heartiest gratitude to Dr. Muhammad Ayub Siddiqui, in the capacity of my supervisor, for his valuable guidance throughout this thesis and for his kind, timely and valuable inputs as and when required. It would not have been possible to write this dissertation without his help and support of the excellent/top notch faculty members provided by Bahria University's management, in our MPhil course work, like Dr. Muhammad Ayub Siddiqui, Ms. Kishwar Sameen, Dr. R. K. Malik, Dr. Zahid Mahmood being the MPhil program coordinator and Dr. Mahboob. Further, I would also like to express my deepest gratitude to my family members, sincere friends and specially my parents as they always supported, encouraged and remember me in their prayers and best wishes.

(Asad Ullah)

*This thesis is dedicated to my Teachers, Family
and Friends for their endless love, support and
encouragement.*

TABLE OF CONTENTS

CHAPTER 1 INTRODUCTION.....	1
1.1 Initial Public Offerings.....	1
1.2 Distinct Regulatory Regime of Pakistan	2
1.3 Problem Statement	5
1.4 Research Objectives	6
1.5 Research Questions	6
1.6 Justification & Significance	7
CHAPTER 2 LITERATURE REVIEW.....	9
2.1 Underpricing.....	10
2.2 Signaling Theory	12
2.3 Winners' Curse Theory	13
2.4 Asymmetric Information Theory.....	14
2.5 Offer Mechanisms and Underpricing.....	15
CHAPTER 3 THEORETICAL FRAMEWORK.....	23
CHAPTER 4 METHODOLOGY	32
4.1 Sample and Data.....	32
4.2 Unit of Analysis	33
4.3 Operationalization of Independent, Dependent and Control variables.....	33

4.4	Statistical Tools in Analysis.....	36
CHAPTER 5 ANALYSIS, FINDINGS AND RESULTS		37
5.1	Description of the data set.....	37
5.2	Descriptive statistics and Analysis.....	39
5.3	Correlation Analysis of the variables.....	42
5.4	Analysis of the Results and Findings	49
CHAPTER 6 CONCLUSION		52
6.1	Conclusion.....	52
6.2	Limitations' of the Research	52
6.3	Suggestions for future research.....	53
REFERENCES.....		54

List of Tables

Table 5.1	Descriptive Statistics of data.....	39
Table 5.2-5.9	Correlation Analysis.....	42

List of Illustrations

Illustration 5.1	Trading Counter.....	37
Illustration 5.2	Offer Type.....	38
Illustration 5.3	Underpricing.....	38
Illustration 5.4	IPO year.....	39

ABSTRACT

This empirical study determines whether Fixed Price Offer Mechanism or Book Building Offer Mechanism is useful for pricing of the Initial Public Offerings (IPOs) in capital market of Pakistan or not. This research will contribute towards better understanding for the dynamics of Pakistani capital market for the companies which are intending to get themselves listed at the stock exchanges of Pakistan. To determine the optimal Offer Mechanism between the Fixed Price Offer Mechanism and Book Building Offer Mechanism, the IPO pricing in Pakistan was studied since the promulgation of the Book Building Regulations in 2008.

Since the introduction of the Book Building Offer Mechanism as an alternative to the Fixed Price Offer Mechanism, the issuance of capital by the new companies through this mode of offering is getting pace with each passing year. This is mainly due to its inherent feature of price discovery by the well informed institutional and high net worth investors. Since promulgation of the Book Building Mechanism till today witnessed 36% of the total IPOs came through this mode. But it cannot be concluded that Book Building Offer Mechanism has fully superseded the Fixed Price Offer Mechanism for IPO pricing.

The underpricing was measured by First day return. The descriptive statistics was used to empirically test the optimal Offer Mechanism for controlling underpricing of 22 IPOs during the years 2008 till 2013. From the empirical analysis it was concluded that Fixed Price Offer Mechanism controlled the underpricing of IPOs as compared to Book Building mechanism. The findings of this research are consistent with the findings of literature wherein Fixed price offer mechanism controls underpricing to a greater extent (Sherman, 2005; Derrien & Womack, 2003). These findings are in contradiction with the findings of other researchers regarding Book Building Offer Mechanism as optimal for controlling underpricing (Bubna & Prabhala, 2008; Sherman, 2005; Cornelli & Goldreich, 2001; Sherman, 2000; Benveniste & Wilhelm, 1990).