INTERNATIONAL JOURNAL OF ECONOMICS AND FINANCE STUDIES
Vol 3, No 1, 2011 ISSN: 1309-8055 (Online)

The Initial and First Year Returns of Firms Listed on the Damascus Securities Exchange: Some Preliminary Findings.

Zeina AL-AHMAD

Faculty of Economics, Tishreen University, Lattakia, Syria.

Email: zalahmad@scs-net.org

Abstract

The Damascus Securities Exchange (DSE) was launched on the 10th of March of 2009 with six listed firms. After two years from its first operation, the number of the listed firms has increased to reach twenty. This paper aims to shed light on the institutional framework of the DSE and to provide some findings on the initial and first year returns of firms listed on it. Consistent with the international evidence, the results indicate that, Syrian IPOs are significantly underpriced. When examining the determinants of this underpricing, the analysis reveals that the age of the firm is the only variable that is significantly linked to the underpricing level where old firms are more underpriced than young firms. In terms of the first year performance of the listed firms, the findings indicate that Syrian IPOs experience positive first year post listing returns.

Keywords: IPOs, initial and post listing returns, emerging markets, Damascus, Syria.

JEL Classification: G32.

1. Introduction

After a long opposition to the market system, in 2000, Syria started reforming its economy by moving from a social based system into a social-market based one. To achieve its aims, the government adopted some stabilization measures and structural reforms in all aspects of the economy. This included steps toward liberalizing its trade and giving more role to the private sector especially in the banking and insurance industry (Brück et al., 2007). As a part of moving into the social market based economy, in 2006, the act no.55 was passed on. According to this act, the Damascus Securities Exchange (DSE) was to be established. Although the Act was passed on 2006, the exchange was not launched until the 10th of March 2009. The delay in opening the DSE is believed to have helped in allowing for more private banks, insurance companies and brokerage houses to enter the market. After two years from its first launch, the size of the market increased from 6 companies to include 20 companies with a market capitalization of 128 billion Syrian pounds which is equal to 1.5% of the Syrian GDP (DSE website, trading information).

This research aims to shed some light on the market structure of the DSE and the going public process on it. It also aims to provide preliminary findings on the initial and first year post issue performance of the firms listed on the DSE and on the determinants of this performance. The findings reveal that Syrian IPOs experience positive first day, first month and first year returns.

This paper contributes to the emerging markets literature as it is, to the best of my knowledge, the first study that examines the institutional framework and the going public process on the DSE. The paper also contributes to the IPO literature as it provides new international evidence on the underpricing and post listing returns of IPOs in one of the MENA countries where only few researches have been conducted. The rest of the paper is organized as follows: Section two discusses the institutional framework of the DSE. Section three displays a short background on the initial and post listing returns phenomena and clarify the sample data and the research methodology. Section four discusses the empirical findings and section five concludes the paper.

2. Institutional Framework

As the majority of the Syrian companies are family owned businesses, public limited corporations are not yet that common in Syria (Alglailati, 2007); and thus, getting listed on the exchange usually takes on two steps. The first one whereby companies issue shares to the public and move into a public limited corporation (PLC) form, and the second one, whereby the PLC satisfies the DSE listing rules and gets itself listed on it. Worth noting that companies may do the first step but without providing a clear timeline regarding when they will be able to do the next step .i.e. getting listed on the exchange. As a result of this, the date of going public is usually different than the date of listing. When it comes to issuing shares to the public, the Syrian Commission on Financial Markets and Securities (henceforth SCFMS) authorized brokerage houses to do security offerings through best efforts and no brokerage house was authorized to do security underwriting. Worth noting that all the offers are fixed-price ones and bookbuilding is not common at all in Syria.

Once the PLC satisfies the DSE listing rules and decides to get listed on one of its markets, the DSE chooses an exploratory price, which is the starting price for trading. The DSE sets the exploratory price as equal to the face value of the stock for firms listed on the main and growth A markets. However as for firms listed on the growth B market, the exploratory price is the lowest of either the book value or the face value of the stock (DSE website, general news). Until February 2011, the price, on the first day of trading, was allowed to fluctuate within 15% of the exploratory price. However, now, it is allowed to fluctuate freely. After the first day of trading, the fluctuation's limit is narrowed down. More specifically, as the exchange was shortly launched after the 2008 financial crisis, huge concern and skepticism were dominating the Syrians regarding the risk associated with investing their savings on it. To alleviate the doubts about the DSE, the SCFMS enacted few rules to insure that the exchange does not become a speculative one. For example the SCFMS requires that stocks can not be bought and sold on the same day; prohibits short selling and margin buying; and does not allow share prices to fluctuate beyond a 2% limit of the reference price, which is usually, the closing price of the previous day of trading. Worth noting that according to the DSE rules the closing price is not considered as a new reference price unless at least 200 shares of this stock has been traded on that day, if not, then the previous reference price will remain unchanged (DSE website, general news). In case of distributing dividends, malpractice by some market participants, conducting seasoned equity offerings, the exchange sets a new reference price. The exchange also changes the reference price in case the security is offered at the lowest price with no opposite orders to buy or at the highest price with no opposite orders to sell (DSE website, general news).

On the 31 of December 2009 the DSE weighted price index (DWX) was launched. The index consists of all the firms that are listed on the DSE. The weights on the index are calculated based on the market value of each company to the market value of the companies involved in the calculation of the index. Worth noting that before the launch of the DWX, the Audi index was in use. This index was launched by Audi bank on the same month at which the DSE started operating.

Although, the DSE was launched with two markets, the Main and the Growth one, starting from January 2010, several attempts were made to enhance companies to get listed on the market; and as a result the Growth market was split into Growth A and B. Growth A has the same requirements of the old Growth market but Growth B has more relaxed ones in terms of the capital required, the number of shareholders, and few other requirements (DSE website, listing requirements).

The increase in the number of trading days was another procedure taken by the DSE in order to enhance trading on the exchange, and indirectly encourage firms to get listed on the DSE. On its first launch, trading on the market was to take place on two days of the week only. Gradually, the number of trading days has increased, and now, since February 2011, trading takes place on five days a week, Sunday to Thursday from 11 to 1 pm. In addition, to increasing the number of trading days, the price limit imposed by the DSE on stock prices has been increased from ±2% into ± 3% of the reference price starting from mid February.

Despite the several attempts to enhance the market, table one, which provides a descriptive statistics of the sample, reveals that the number of listed corporations is still very modest not to mention that 80% of the listed firms are from the banking and insurance sector. Although no previous study has examined the reasons behind the fact that firms are opting out of listing on the DSE, I believe that the increased level of disclosure that should be adhered by the listed firms is a main reason for not getting listed. In fact, even large and well-known firms in Syria do not voluntarily disclose information to the public, and very few of them have a useful website. Moreover, the price and trade restrictions that are imposed by the exchange, as explained earlier, could be another reason behind opting out of listing on the market especially that these stocks could be traded on the OTC without any restrictions on their trading prices or quantities.

Table one: Descriptive Statistics of the Sample

Panel A: Descriptive Statistics of the Sample in Terms of the Market of Listing and the Industrial Sector.

	No of IPOs	Percentage of IPOs
Market of listing		
Main	10	50%
Growth A	7	35%
Growth B	3	15%
Total	**20**	**100%**
Industrial sector		
Banking	12	60%
Insurance	4	20%
Services	2	10%
Agricultural	1	5%
Industrial	1	5%
Total	**20**	**100%**

Panel B: Descriptive Statistics of the Sample in Terms of the Age and the Size of the Firms.

	N	Mean	Median	STD	Min	Max
Age (years)	20	4.91	3.6	5	0.45	20.67
MC (S.P. M)	20	2317	2250	1544.9	140	5000

*Notes: **MC** is the market capitalization measured as the product of the issue price and the total number of shares issued and fully paid. The **Age** of the firm is the length of the operating history measured from the date of incorporation until the date of going public.*

In terms of its openness to international investors, the DSE is still to a large extent, a closed market. To be more specific, although all the banks and insurance companies that operate in the Syrian market have international investors, mainly the mother bank, one important feature of the DSE is how it treats foreign investors. It is interesting to know that even after liberalizing the previously tightly closed economy, foreign investors still can not freely enter or exit the DSE. To be able to trade, investors should open an account in Syrian Pounds with the brokerage house where this account is fed by deposits in foreign currencies at the authorized bank. The deposits are transferred from abroad and are to be exchanged to Syrian Pounds for the express purpose of trading. Worth noting that the exchange should be monthly informed about the names of the international investors in each listed firm. Should the investor want to repatriate the capital gains and the deposits before six month of the date at which he/she transferred the deposits into Syrian Pounds, the Exchange deducts 50% of the profits resulted from trading for each deposit. Should he/she wish to repatriate after six month but before the end of the first year, the Exchange deducts 25% of the profits resulted from trading for each deposit. This means that unless the investor waits for a year, he will leave some money on the table for the exchange (DSE website, laws and acts).

3. The Initial and Post-Listing Returns Phenomena

The empirical literature documents the existence of abnormal returns earned by IPO investors on the first day of trading, or what is called ‘the underpricing’. According to Loughran et al., (1994), the underpricing is a common phenomenon in all countries that have stock markets. However, the degree of underpricing differs between different countries. Similar to the underpricing phenomenon, a large body of evidence shows that IPOs tend to underperform matching firms that did not go public in the long run (Loughran et al., 1994). Unlike the ample literature that examines the underpricing and the long run underperformance of IPOs in the US and the UK and to a less extent Europe and East Asia, very little research is done to examine these phenomena in the Arab countries. Findings reported from the MENA region by Hearn (2010) and the Gulf Cooperation Council Countries (GCCC) by Al-hassan et al., (2007), indicate that IPOs in these Arab countries are significantly underpriced. As for the post issue performance, while Al-hassan et al., (2007), report that IPOs in the GCCC experience negative first year returns after excluding the initial returns, Saleh & Mashal (2008) could not reach a conclusive conclusion regarding the post issue performance of Jordanian IPOs.

To examine the initial and first year post issue returns experienced by Syrian IPOs, all firms that were listed on the DSE during the period March 2009–March 2011 were included in the sample. The list of the listed firms, their offer prices and their first day and first month stock prices, their dates of incorporation, their dates of listing, their industrial sectors are all hand collected from the DSE website.

As pointed out by, Beatty and Ritter (1986) initial returns are thought to be linked to the level of the asymmetric information of the offering firm. Several firm and offer characteristics were used in the literature as proxies for asymmetric information. In this study I examine whether initial returns are linked to each of: the market of listing, the sector in which the firm operates, the age of the firm, and the size of the firm. Due to the small size of the sample, examining the determinants of initial returns by running a multivariate OLS regression is not possible; and thus, a univariate analysis is conducted to find out the firm and offer characteristics that might affect the initial returns.

The first year post issue performance is measured through the cumulative abnormal returns (CAR). The statistical significance of the CAR is assessed following the Brown and Warner (1980) crude dependence adjustment T test, which corrects for the cross-sectional dependence. Although the exchange was launched two years ago, half of the sample has not completed their first year as a listed corporation; and thus, only firms that have price data for one year are included in the sample that is used to calculate the CAR. Due to the small size of this sample, the determinants of the first year post issue performance were not examined.

4. Empirical Findings

Table two, which reports the initial returns of the sample, reveals that the sample mean (median) initial returns is 53.87% (47.20%) with a minimum of 2.4% and a maximum of 126.8%. The parametric T test and the non-parametric Wilcoxon test reveal that Syrian IPOs are significantly underpriced at the 0.1% level of significance. The table also reveals that initial returns measured by using the first month closing price rather than the first day, are also significantly different from zero.[1]

Table two: Descriptive Statistics of the Initial Returns

	N	Mean%	Median %	STD	Min %	Max %	Parametric Test	Non-parametric tests
Initial returns (first day)	19	53.87	47.20	35.01	2.40	126.8	T=6.71 (0.00) ***	Z=3.82 (0.00) ***
Initial returns (first month)	19	68.99	63.30	39.96	10.40	136.25	T=6.5 (0.00) ***	Z=3.26 (0.001) ***

Notes: The ***Initial return****s for company (i) are reported on the first day of trading and the first month of trading*[2] *and are calculated as the difference between the closing price on the first trading day/trading month and the offer price divided by the offer price. P values are reported between brackets. *** implies that the variable is significant at the 0.1% or better.*

When examining the determinants of initial returns, the univariate analysis reported in Table three reveals that the underpricing experienced by firms listed on the Main market (mean=65.38%) is higher than that experienced by those listed on the Growth market (mean=41.087%). Unlike the parametric T test which reveals that the differences in the underpricing levels between the two markets are not statistically significant, the non parametric Mann-Whitney test reveals that the level of underpricing is significantly different between the two markets, though at the 10% level. Unreported results reveal that the difference in the underpricing levels between the two markets is basically driven by the difference between firms listed on the Growth B and those listed on the Main market.

[1] One of the firms has been listed since January 2011 however, no trading occurred on its stocks yet; therefore, the size of the sample was reduced to 19 firms.
2 This is to take into account that similar to other emerging markets, trading on some stocks on the DSE is thin.

The Table also reveals that the underpricing experienced by firms in the banking and insurance sector (mean=46.08%) is less than that experienced by firms in other sectors (mean=83.07). The differences in the means and medians of the initial returns between the two groups are statistically significant at the 10% level. Worth noting that unreported results reveal that there are no significant differences in the underpricing level between firms in the banking sector and those in the insurance one.

The age of the firm appears to be positively affecting the underpricing level where old firms (73.22%) are more underpriced than young firms (32.37%) and the differences in the underpricing levels between the two groups are statistically significant at the 5% level.

Unlike the rest of the variables examined, it appears that the size of the firm does not have any significant impact on the underpricing level.

Worth noting that the fact that firms in the Main market and older firms are more underpriced than other firms is inconsistent with the asymmetric information explanation of underpricing. However, it also reflects that investors are more confident in the performance of these firms, and thus more willing to buy their shares in the market, driving their stock prices up.

Table three: Univariate Analysis of the Role of the Market of listing, Industrial Sectors, Age, and Size, in Explaining Initial Returns

	N	Mean %	Median %	STD	Parametric test	Non-parametric test
Market						
Main	10	65.38	59.85	26.73	T=1.57	Z=1.92
Growth	9	41.08	31.1	40.05	(0.13)	(0.053) *
Industrial sector						
Banking & Insurance	15	46.08	43.5	29.86	T= 2.03	Z=1.8
Non Banking &	4	83.07	89.5	41.85	(0.058) *	(0.08) *
Age						
Old	10	73.22	72.5	33.93	T=3.152	Z=2.491
Young	9	32.37	31.1	21.79	(0.006) **	(0.01) **
Size						
Large	10	48.64	51.1	36.37	T=0.67	Z=0.6

Small	9	59.68	47.2	34.6	(0.51)	(0.604)

Note*: the **market of listing** is a dummy variable that takes the value of one if the firm is listed in the Main market and zero otherwise. **Industrial sector** is a dummy that takes the value of one if the firm operates in the banking and insurance sector and zero otherwise. **Old/Young** firms are those with age that is higher/lower than the median age of the sample. **Large/Small** firms are those with market capitalization higher/lower than the median market capitalization of the sample*.

Table four reports the first year performance of the sample. The table reveals that unlike the evidence reported in other Arab countries, Syrian IPOs have a positive first year post issue performance. Unreported results reveal that this holds even after excluding the initial returns earned by IPO investors in the first month of trading. Moreover, unreported results reveal that, when using the buy and hold abnormal returns (BHR) rather than the CAR, Syrian IPOs also experience positive first year performance similar to the one reported when using the CAR.

Table four: The First year returns of firms listed on the DSE

Month after the IPO	Average Abnormal returns	Cumulative average abnormal returns	Crude dependence adjusted T statistics for CAR
1	10.96	10.96	2.76**
2	9.62	20.58	3.66**
3	4.65	25.23	3.67**
4	-0.64	24.6	3.10**
5	2.15	26.75	3.01**
6	0.04	26.79	2.75**
7	0.59	27.38	2.6**
8	3.64	31.02	2.76**
9	5.02	36.04	3.02**
10	5.80	41.84	3.33**
11	-2.04	39.79	3.02**
12	2.29	42.08	3.067**

Notes: The statistical significance of the cumulative abnormal returns is assessed following the Brown and Warner (1980) Crude Dependence Adjustment T test, which corrects for the cross-sectional dependence.

5. Conclusion

This study examines the institutional framework of the DSE and the initial and first year performance of firms listed on it. The study reveals that Syrian IPOs experience positive initial and first year post listing returns. Amongst the explanatory variables that were used to define the determinants of the underpricing experienced by Syrian IPOs, the age of the firm appears to be the most significant variable where old firms are more underpriced than young ones. I acknowledge that the limited size of the sample casts doubts on the extent to which these results can be generalized; and thus, further research is needed to confirm the reliability of these results and to examine whether the positive post listing returns extend beyond the first year of listing.

Bibliography

Alglailati, Mohamad (2007), "Family Companies' Conversion Requirements to Contribution Companies", *DSE Research Working paper.* Damascus: DSE.

Al-Hassan, Abdullah, Fernando Delgado and Mohammed Omran (2007), "IPO Behavior in GCC Countries: Goody-Two Shoes or Bad-to-the-Bone?", *IMF Working Paper WP/07/149*. Middle East and Central Asia Department: IMF

Beatty, Randolph and Jay Ritter (1986), "Investment Banking, Reputation, and the Underpricing of Initial Public Offerings", *Journal of Financial Economics,* Vol. 15, No. 1-2, pp. 213-232.

Brown, Stephen, and Jerold Warner (1980), "Measuring Security Price Performance", *Journal of Financial Economics,* Vol. 8, No. 3, pp. 205-258.

Brück, Tilman, Christine Binzel and Lars Handrich (2007), "Evaluating Economic Reforms in Syria", *Deutsches Institut für Wirtschaftsforschung Politikberatung kompakt 35*. Berlin: GTZ.

DSE website: http://www.dse.sy/ [Accessed 30.03.2011]

Hearn, Bruce (2010), "The performance and the effects of family control in North African IPOs" *University of Leicester Working Paper.*

Loughran, Tim, Jay Ritter and Kristian Rydqvist (1994), "Initial Public Offerings: International Insights", *Pacific-Basin Finance Journal*, Vol. 2, No. 2-3, pp. 165-199.

Saleh, Walid, and Ahmad Mashal (2008), "The Underperformance of IPOs: The Sensitivity of the Choice of Empirical Method", *East-West Journal of Economics and Business,* Vol. XI, No. 1 & No. 2, pp.34-52.