

## **From the Second Board to the Main Board: Does Transfer of Listing Matter?**

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### **Abstract**

This study seeks to evaluate the impact of transfer of listing of the companies in the Second Board to the Main Board of KLSE on the stock price and trading volume. We argue that the Main Board firms are more exposed to analyst scrutiny and are more glamorous which enable them to attract more institutional investors. This, in turn, will increase the liquidity of the firms' stocks. We try to evaluate whether news about the transfer of listing has information content, and whether liquidity will be affected in the longer term. Specifically, three hypotheses are tested to determine (1) whether news about the transfer of listing moves the stocks' prices, (2) whether news about the transfer of listing changes the trading volumes, and (3) whether the average trading volumes, as a measure of liquidity, are higher in the long-term for the firms after they are transferred to the Main Board of KLSE. The results show that in general, the transfer announcements of firms in the Second Board to the Main Board of KLSE do affect the stock prices. The average trading volume does increase in the event window, though not significantly. However, the average trading volume has significantly increased after the event window. Hence, it seems that the liquidity of the firms has improved especially in the longer term.

### **I. Introduction**

Previous studies have presented evidence regarding the value of a major stock exchange listing (Sanger and McConnell, 1987, 1990; Ying, *et al.*, 1977). They argue that there will be an improvement in liquidity because being listed in a major stock exchange stimulates the demand for a firm's stock which could lead to a permanent increase in stock price. In the Kuala Lumpur Stock Exchange, some of the Second Board firms with high growth potential and determination to succeed have applied to be transferred to the Main Board. Among others, this initiative is motivated by several reasons. First, they want to attract more institutional investors to invest in their shares. Second, the application for listing transfer reflects the managers' confidence in the future prospect of the firm. Third, the listing on the Main Board will enhance the image of the company locally and internationally. Finally, the management wants to convey the message that the firm's

stock is currently undervalued. These reasons seem to be leading to two important perceived aspects of successful stock. First, going to the Main Board could lead to higher liquidity of the stocks. Second, it could attract more scrutiny and coverage by the market analysts. And it is important to note that analyst recommendations have been proven to convey valuable information to the markets (Ho & Harris, 1998), and that market coverage and scrutiny help firms to avoid the negative impact of being neglected (Beard & Seas, 1997; Arber & Strebel, 1983).

This study will investigate whether the transfer of listing to the Main Board of KLSE would make any difference on returns as well as volumes of trading of the former second boarders. Apart from concentrating on the stock price behavior and volume surrounding the transfer announcements, this study will also focus on the longer term trading volumes as well in order to examine liquidity. Given the argument that being listed on the Main Board will expose the firms to more market scrutiny, it can be argued therefore that the transfer from the Second Board to the Main Board will lead to an increase in the trading volumes of the firms over the longer term.

## **II. An Overview of Security Commission (SC) Listing Requirements**

Information regarding the requirements of listing in the KLSE is extracted from the listing requirements booklet, published by the Securities Commission (SC) and KLSE. Below are some overviews regarding the listings.

Basically, firms in the Second Board are considered smaller firms relative to firms on the Main Board. Their minimum issued and paid-up capital is RM40 million, comprising ordinary shares not less than RM1 each. In addition, the firms should have an uninterrupted after-tax profit record for the past three to five full financial years. Furthermore, their aggregate after-tax profit should be at least RM12 million over the stated period of uninterrupted after-tax profit while their most recent financial year should generate a minimum after-tax profit of RM4 million. These are some of the Second Board listing requirements.

A company listed on the Second Board may be considered for a transfer to the Main Board of KLSE provided that the listed company meets the requirements for listing on the main board and/or such other requirements as may be imposed by the Exchange and it obtains the prior approval of the Security Commission. Among others, the listing requirements state that the company should have a minimum paid up capital of RM60 million, comprising ordinary shares of not less than RM1 each. The historical profit performance should have an uninterrupted after-tax profit record for the past three to five full financial years. The aggregate after-tax profit of at least RM30 million over aforesaid period, and a minimum after-tax profit of RM8 million for the most recent year. The firm must also have been listed on the Second Board for at least three years.

However, an exception could be granted by the Security Commission if the company shows a very high financial performance and the potential for growth is highly likely. Thereby, the company could apply for transfer listing after one year after being

listed on the Second Board. In this study there are three such companies, namely Octagon Consolidated Berhad, Top Glove Corporation and Uchi Technologies Berhad.

From January 1991 to December 2002, 66 companies have been transferred from the Second Board to the Main Board of KLSE. These transfers are usually initiated by the management themselves.

### **III. Review of Literature**

Generally, the information content of any public information can be perceived as good news or bad news to the market participants (Mitchell & Mulherin, 1994). For the case of stock exchange listings, it is usually taken as a good news. This is so because theoretically a listing will increase the stock price and trading volume, and exposed it more to the market. The following review will help to shed some light on whether transfer of listing announcements have information contents.

#### *Common Stock Listings*

A number of studies (for examples Sanger and McConnell, 1986, 1987; McConnell And Sanger, 1987, Jain, 1987) have examined common stock returns around the time at which the stocks are listed on major stock exchanges. These studies cover a variety of time periods and employ a variety of empirical methodologies, but they reveal two common observations. First, stocks appear to rise in price immediately prior to listing. Second, stock prices appear to decline immediately thereafter. They observations may, in effect, question the validity of market efficiency theory.

Sanger and McConnell (1987) document this phenomenon in detail and suggest two possible explanations. The first encompasses the possibilities of having inaccuracies or errors in the data. These explanations imply that the observed negative post-listing stock returns are still consistent with the concept of an efficient capital market because they preclude the existence of a profitable trading rule. The second category encompasses explanations that have their origins in *ad hoc* theorizing or *streetlore*. These explanations may be sustained by the data, but they are still inconsistent with the concept of an efficient capital market because they leave intact an apparently profitable trading rule. However, no full explanation has been given by the researchers.

In February 1971, the National Association of Securities Dealers Automatic Quotation (NASDAQ) system was implemented in the OTC market. This system allows instantaneous communication of bid and ask quotations among OTC dealers and brokers. Sanger and McConnell (1986) have examined the behavior of common stock returns for samples of OTC firms that were newly listed on the NYSE both before and after the introduction of NASDAQ communication system in the OTC market. They observed that in the pre-NASDAQ period, a positive and significant reaction by the capital market to the news of a major stock exchange listing. In the post-NASDAQ period, a reduced and statistically significant capital market reaction to initial announcements of impending exchange listings. This resulted from the superior liquidity services provided by the

NYSE and the introduction of NASDAQ in the OTC market has reduced the liquidity advantage provided by the NYSE. In this study the transfer to the Main Board are expected to provide greater liquidity to the Second Board firms.

### *Common Stock Delistings*

A firm may be delisted at the initiative of the Exchange or the firm may file an application with the SEC to voluntarily withdraw its stock. Most delistings result from a failure to meet numerical standards such as a minimum net income, a minimum number of round lot shareholders, or a minimum market value for shares outstanding. Many studies have documented evidence that the firms' values are negatively affected when their stocks are delisted from a major exchange. Unlike results for stock exchange listings, returns following delisting appear to be consistent with market efficiency. Efficient market theory suggests that the market prices of the delisted securities should have not changed after the delisting date, because the delisting would have had no effect on their expected future returns.

According to Sanger and Peterson (1990), the observed loss in firm value is likely due, in part, to the decrease in liquidity that accompanies delisting. Jain (1987) studied the effect on stock price regarding the inclusion in or exclusion from the S&P 500. He found on average, the excluded firms experienced an excess return on day 0 of -1.16 percent (t-statistic=-2.3). This is significant at the 5 percent level. On day 0, 65 percent of the excess returns were negative, which indicates that the result was not driven by a few outliers. These results corroborate the earlier findings.

In a study to see the effect of delisting from the S&P 500, Goetzmann and Garry (1986) suggested that listing and delisting represent a particular type of information that is unrelated to other characteristics. Delisting from the S&P 500 apparently carries clear signals to the market about such seemingly uncertain issues as future standard deviation of analysts' earnings prediction as well as the future quality of information about a company.

The literature on listing and delisting will give some insight to this study since there no similar studies have been conducted regarding the transfer of listing. Generally, the studies of listing might have more similarities with this study since both events are likely to have similar characteristics. The stock exchange listing and transfer of listing most probably will convey good news to the investors. Thereby, the results more or less might be comparable. Nevertheless, the studies on delisting produce a view as to what the market participants perceived as bad news.

As we are looking at the impact on price and trading volume of the transfer of listing announcement, we are implicitly looking at whether or not the market fully and quickly digest the news. This means that we are looking at the efficiency of the market.

## **IV. Methodology**

Secondary data are retrieved from various sources. The information regarding the companies that have been transferred from the Second Board to the Main Board of KLSE over the period of January 1991 to 2002 are obtained through the KLSE website at [www.klse.my](http://www.klse.my). Daily closing prices and trading volumes for each company in the sample, as well as the Composite Index, EMAS Index and Second Board Index, are extracted from the *DownLoader pkpdata* disc, obtained from Pusat Komputer Profesional Sdn. Bhd, Kuantan., Pahang. The announcement dates are collected from KLSE website and the company files kept in KLSE library.

As mentioned, we wanted to see if the transfer announcement carries any information so that it will affect the price and trading volume in the period surrounding the announcement, and if firms' liquidity increase after they are listed on the Main Board. Therefore, we will test three hypotheses as below:

- H<sub>1</sub> : Average abnormal returns during the event window are greater than zero.*
- H<sub>2</sub> : Trading volume is greater after the announcement day.*
- H<sub>3</sub> : Trading volume is greater for one year period after the event window.*

Besides, we will also compare the returns of the Second Board and Main Board, in order to establish their overall statistics. The market excess returns will be calculated, whereby the returns of the Second Board and EMAS indices, representing the former and later respectively, will be compared with the KLSE Composite index.

In order to test H<sub>1</sub> and H<sub>2</sub> the standard event study methodology will be used (see Strong, 1990). The stock abnormal return (AR<sub>jt</sub>) can be calculated as follows:

$$AR_{jt} = R_{jt} - E(R_{jt}) \quad \dots\dots\dots (1)$$

where:

- R<sub>jt</sub> = the actual daily return on stock *j* at time *t*
- E(R<sub>jt</sub>) = the expected daily return of stock *j* at time *t*

The actual and expected returns need to be calculated first before computing the securities abnormal return. In this case, the actual return can be expressed as follows:

$$\text{Actual return}_{it} = R_{it} = \frac{(P_t - P_{t-1}) + D_{jt}}{P_{t-1}} \quad \dots\dots\dots (2)$$

where:

- P<sub>t</sub> = stock price at period *t* for stock *j*
- P<sub>t-1</sub> = stock price at period *t* - 1 for stock *j*
- D<sub>jt</sub> = dividend per share at period *t* for stock *j*

The capital asset pricing model (CAPM) is used to estimate the expected or required return (E(R<sub>j</sub>)) on the securities by using SML equation. Beta of the stock is calculated by

regressing its past returns against past market returns in the market model as shown in equation (3).

$$E(R_j) = RFR + \beta_j (R_m - RFR) \quad \dots\dots\dots (3)$$

where:

- RFR = return on the risk-free asset ( 3-month KLIBOR as proxy).
- $\beta_j$  = beta of the stock  $j$
- $R_m$  = market return at that period, proxied by return on the KLSE CI

The daily abnormal return (AR) of each securities is estimated 90 trading days prior to (- $k$ ) and 90 days after (+ $k$ ) the transfer announcement date (i.e., the event date,  $t = 0$ ). AR is then averaged over the securities in the sample and cumulated over time to compute the cumulative abnormal returns of delisted stocks. The average abnormal return ( $AAR_t$ ) and cumulative abnormal return ( $CAR_t$ ) are shown as below;

$$AAR_t = \frac{1}{N} \sum^N AR_t \quad \dots\dots\dots (4)$$

where:

$AAR_t$  = the average abnormal return for time  $t$  for  $N$  securities

$$CAR_t = \sum_{t-k}^{t+k} AAR_t \quad \dots\dots\dots (5)$$

where:

$CAR_t$  = the cumulative abnormal return for time period  $t = -k, -(k+1), -(k+2) \dots 0, \dots$  to  $+k$ , where  $k=30$

One-sample  $t$ -test is used to test whether the average daily abnormal return ( $AAR_t$ ) and the cumulative abnormal return ( $CAR_t$ ) are significantly different from zero.

Besides looking at the behaviour of price, we will also look at the volume of trading. Usually high trading volume is associated with the arrival of information. This study will examine if there is any evidence of unusual trading volume in the event window and also the trading volume outside the event window. For hypothesis  $H_2$ , the average daily trading volumes in the event window (90 days before and 90 days after the announcement date) are computed for each firm in the sample. The second test (on  $H_3$ ) concerning trading volumes will be conducted by computing the average daily trading volumes during a one-year period before, and during a one-year period after the event window. For both tests the average daily trading volumes are adjusted with that of the KLCI average daily trading volume to get a more robust result. The computed values for

both groups are then tested using the statistical t-test to compare the means of trading volumes for the two groups to determine their significance.

## V. Results and Discussion

The descriptive statistics of the market excess returns for the Second Board Index and EMAS Index are presented in Table 1.

Table 1: Descriptive statistics of market excess return of the EMAS Index and the Second Board Index.

Index	EMAS	Second Board
Minimum	-.03	-.17
Maximum	.03	.25
Mean	.0001	.0004
Std. Deviation	.0044	.2450

On the whole, the table reveals what we have expected of the risk-return profile of both indices. The mean excess return for the Second Board Index is higher than that of the EMAS index, and that its standard deviation is also higher. This implies that small firms' returns are more volatile, and hence riskier, than large firms. The volatility of the Second Board Index is further supported by the fact that it has bigger minimum-maximum range as compared to that of the EMAS Index.

The observation regarding the positive and negative AARs in the event window is summarized in Table 2 below.

Table 2: Summary of AAR observation during the event window

Event window	Positive AAR	Percentage	Negative AAR	Percentage
Announcement date ( Day 0 )	1	-	0	-
Before (days -90 to -1)	46	51.11	44	48.89
After (days 1 to 90)	41	45.56	49	54.44
Total	88		93	

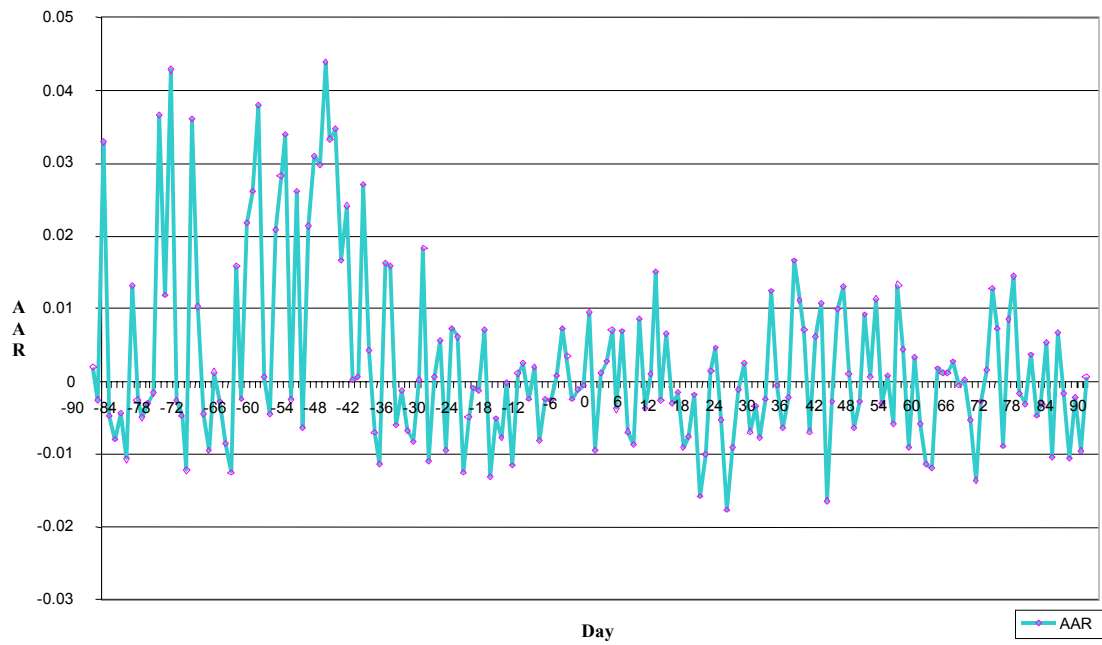
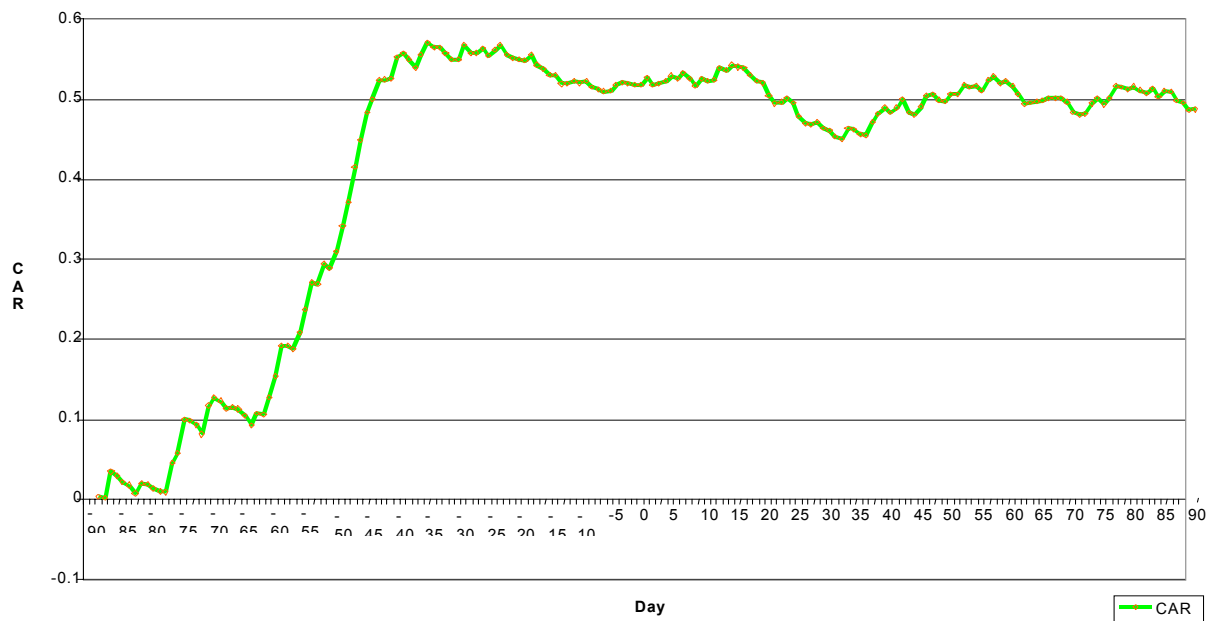


Figure .1 Average Abnormal Return (AAR) on Daily Basis

Figure 2: Cumulative Abnormal Return (CAR) in the Event Window





Altogether, there are eight significant AARs observed during the event window. The respective days are on day -83, -65, -38,-19,-14, 20, 25 and 43. Before the announcement day, there is one positive significant AAR (day -83) and four negative AARs. Whereas after the announcement day, all 3 are negative AARs.

The highest daily AAR of 4.4 percent is observed on day -48, whereas the lowest AAR of -1.76 percent is observed on day 25. Figure 1 shows the AAR plotted against the days in the event window. The trend from Figure 1 indicates that stock prices are more volatile before the announcement date. It seems that the difference in excess returns for the consecutive days before the announcement is more volatile than after the announcement. This trend is more obvious between day -90 and -40. It looks like market participants are expecting the good news, and those who got the information well before the initial announcement seem to be making good money. The AAR starts to show a stable trend from day -37 with a random movement until day 90.

The cumulative abnormal returns (CAR) for the whole event window is found to be 48.50 percent. The t-test of CAR from day 0 to day 90 indicates that the value is significantly different from zero, and it is significant at 1 percent significant level (t-stat = 218.20, p-value < 0.001). The mean is found to be 50.01 percent. To better reflect the trend of CAR during the event window, Figure 2 is plotted and shown above.

Some observations can be made from Figure 2 regarding the movements of CAR during the event window. There is a sharp climb in CAR trend starting around day -80 and reaches its peak on day -36. The highest CAR value recorded is 56.90 percent on day -36. From day -52 to day -40, the sharp increase is uninterrupted. Within that period alone, CAR has increased by 48.30 percent. A slight increase and decrease in CAR values are observed from day -36 until it approaches day 0. This trend continues until day 14 with CAR increase to 54.10 percent, the highest CAR observed after the announcement day. The downward trend seems to be taken place thereafter until it reaches the lowest CAR (44.90 percent) on day 32. During this time CAR decreases about 9.20 percent. From the lowest point after the announcement day, CAR is gradually increasing until day 57 (52.60 percent) before it starts to show a stable trend towards day 90, with a CAR of 48.50 percent. The movements of CAR values are within the grid lines of 0.4 and 0.6, or to be more precise, along the 0.5 grid line since day -48 onwards. Taken as a whole, the stabilizing effect in the CAR trend seem to have started thereafter.

The general results reveal that the announcement creates significant abnormal returns surrounding the announcement. In fact, the market has formed its expectation many days even before the official announcement regarding the transfer of listing is made. The price generally remains more or less stable after the announcement. These results are consistent with semi-strong efficiency. Thus it indicates that the KLSE is semi-strong efficient regarding the transfer announcement of firms from the Second Board to the Main Board of KLSE.

## **Trading Volume**

There are two hypotheses concerning trading volumes. The findings on the differences of trading volumes during the event window and outside the event window are summarized in Table 3.

Table 3: Summary of findings on trading volume

Period	Category	Mean difference <sup>a</sup> (after-before)	t-stat	p-value
During event window	90 days before & 90 days after announcement	23 lot	0.52	0.61
Outside event window	1-year before & 1- year after event window	116 lot	-2.12*	0.04

<sup>a</sup> The mean difference measures the average difference (after minus before transfer) in the number of daily trading lot of the sample companies

\* significant at 5 % level

#### *Trading Volumes During the Event Window*

The results for the average trading volumes in the event window - 90 days before and 90 days after the announcement - indicate that the mean difference is not significantly different from zero. Basically it shows that the transfer announcement has no impact on the average trading volume in the event window. Thus, there is not enough evidence to infer that the trading volumes differ within the 90 days before, and 90 days after the announcement day. Thereby, we reject hypothesis H<sub>2</sub>. These results might indicate that an increase in price is not necessarily followed by a sudden increase in trading volumes. The changes in trading volumes might take a longer period before it could be observed.

#### *Trading Volumes Outside the Event Window*

The average trading volumes during the period of one-year before and one-year after the event window produce a different result. The test shows that on average, trading volume has increased by 116 lots daily after the listing transfer. This is significant at 5 percent level. From this evidence, we can therefore conclude that as the former Second Board firms get relisted on the Main Board, their liquidity has increased. And this strengthens our earlier argument that being in the main board will exposed these firms more to market scrutiny. Hypothesis H<sub>3</sub> is therefore accepted.

## **VI. Conclusion**

In this study, we investigated the impacts on price and volume of stocks whose listed shares are transferred from the Second Board to the Main Board of the Kuala Lumpur Stock Exchange. The overall results suggest that the share prices have increased due to the transfer announcement. In fact the increase in the price takes place many days before the news is made public. With regards to the trading volume, we observe that the volumes of trading have also increased. However, it takes a longer time before this increase in trading volume is significantly observed. This strengthens our arguments that being listed on the Main Board of KLSE will expose the firms more to market coverage and scrutiny.

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