The Impact of Changes to Components of Composite Index on the Affected Stocks

Lu Ming Pey

A thesis submitted to the fulfillment of the requirement for the degree
Master of Science (Banking)
College of Business
(Division of Finance and Banking)
University Utara Malaysia
2010

© Lu Ming Pey, 2010. All right reserved
KOLEJ PERNIAGAAN  
(College of Business)  
Universiti Utara Malaysia  

PERAKUAN KERJA KERTAS PROJEK  
(Certification of Project Paper)  

Saya, mengaku bertandatangan, memperakukan bahawa  
LU MING PEY (803912)  

Calon untuk ijazah Sarjana  
(Candidate for the degree of)  
MASTER OF SCIENCE (BANKING)  

telah mengemukakan kertas projek yang bertajuk  
(has presented his/her project paper of the following title)  

THE IMPACT OF CHANGES TO COMPONENTS OF COMPOSITE INDEX  
ON THE AFFECTED STOCKS  

Seperti yang tercatat di muka surat tajuk dan kulit kertas projek  
(as it appears on the title page and front cover of the project paper)  

Bahawa kertas projek tersebut boleh diterima dari segi bentuk serta kandungan dan meliputi bidang ilmu dengan  
(memuaskan.  
(that the project paper acceptable in the form and content and that a satisfactory knowledge of the field is covered by  
the project paper).  

Nama Penyelidik  
(Name of Supervisor)  

DR. KAMARUN NISHAM B TAUFIL MOHD  

Tandatangan  
(Signature)  

Tarikh  
(Date)  

11 OCTOBER 2010
PERMISSION TO USE

In presenting this dissertation in partial fulfillment of the requirements for a postgraduate degree from University Utara Malaysia, I agree that the University’s library may make it freely available for inspection. I further agree that the permission for copying of this dissertation is any manner, in whole or in a part, for scholarly purposes may be granted by my supervisor or, in their absence, by the Dean of College of Business. It is understood that any copying or publications or use of this dissertation or thereof for financial gain shall not be allowed without my written permission. It is also understood that due recognition shall be given to me and to University Utara Malaysia for any scholarly use which may be made of any material from my dissertation. Request for permission to copy or to make use of materials in this dissertation, in whole or in a part, should be addressed to:

Dean of Research and Postgraduate Studies  
College of Business  
University Utara Malaysia  
06010 Sintok,  
Kedah Darul Aman
ABSTRACT

Based on the belief that stock market performance should reflect stock liquidity, Bursa Malaysia (BM) works with Financial Times Stock Exchange (FTSE) to introduce a new market index, known as FTSE-BM30 or FBM30, to replace Kuala Lumpur Composite Index (KLCI). With the introduction of FBM30 on 6th July, 2009, KLCI was discontinued. FBM30 is composed of 30 blue chip stocks while KLCI is made up of 100 stocks. With the introduction of a new index with smaller number of stocks, at least 70 stocks that were previously used to calculate KLCI have to be dropped. The purpose of this study is to look at investors’ reactions to the actual introduction of FBM30 on 6th July, 2009 on the prices of three stocks that are newly included into FBM30, 27 stocks from KLCI that remained in FBM30, and 73 stocks from KLCI that are dropped from FBM30. Using event study methodology, the findings reveal that companies that are newly included into and companies that remain in FBM30 have insignificant abnormal return. However, for the companies that are dropped from KLCI experienced significant abnormal negative return when FBM30 comes into effect.
DECLARATION

I am responsible for the accuracy of all opinion, technical comment and illustration in this project paper except for citation and quotations that have been adequately acknowledged. I bear full responsibility for the checking whether material has been previously or concurrently submitted for any other master's programme at UUM or other institutions. UUM does not accept any liability for accuracy of such comment, report and other technical information claims.

LU MING PEY
ACKNOWLEDGMENT

I would like to express my full gratitude to my supervisor, Senior Lecturer Dr. Kamarun Nisham B Taufil Mohd, for his constant guidance, invaluable advice, suggestion and encouragement throughout my study at University Utara Malaysia.

My sincere appreciations are given to my beloved husband, Kuah Sun Keong and my son Kuah Guan Yee for their patience, encouragement, understanding and ever-lasting love.

My special thanks will always be for the most important people in my life, my lovely family namely, my father, Lu Ah Aik who has been selflessly devoting his life to my family and to the pursuit of excellence in knowledge for all his children. My ever-lasting indebtedness goes to the source of my happiness, my mother, who is simply the most wonderful, amazing woman and the greatest asset and treasure of my life. My constant remembrances are given to my sisters and my brother.

There are many friends that left their heart prints on my hearts. Thank you for your valuable suggestions and constructive comment. I wish you the best!
# Table of Contents

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PERMISSION TO USE</td>
<td>i</td>
</tr>
<tr>
<td></td>
<td>ABSTRACT</td>
<td>ii</td>
</tr>
<tr>
<td></td>
<td>DECLARATION</td>
<td>iii</td>
</tr>
<tr>
<td></td>
<td>ACKNOWLEDGEMENTS</td>
<td>iv</td>
</tr>
<tr>
<td></td>
<td>TABLE OF CONTENTS</td>
<td>v</td>
</tr>
<tr>
<td></td>
<td>LISTS OF TABLES</td>
<td>viii</td>
</tr>
<tr>
<td></td>
<td>LISTS OF FIGURES</td>
<td>ix</td>
</tr>
<tr>
<td></td>
<td>LISTS OF ABBREVIATIONS</td>
<td>ix</td>
</tr>
</tbody>
</table>

## CHAPTER ONE: INTRODUCTION

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.0</td>
<td>Background of The Study</td>
<td>1</td>
</tr>
<tr>
<td>1.1</td>
<td>FBM Bursa Malaysia KLCI</td>
<td>2</td>
</tr>
<tr>
<td>1.2</td>
<td>Problem Statement</td>
<td>4</td>
</tr>
<tr>
<td>1.3</td>
<td>Research Questions</td>
<td>5</td>
</tr>
<tr>
<td>1.4</td>
<td>Research Objectives</td>
<td>5</td>
</tr>
<tr>
<td>1.5</td>
<td>Significance of the Study</td>
<td>6</td>
</tr>
<tr>
<td>1.6</td>
<td>Scope of the Study</td>
<td>6</td>
</tr>
<tr>
<td>1.7</td>
<td>Organization of the Study</td>
<td>7</td>
</tr>
</tbody>
</table>

## CHAPTER TWO: LITERATURE REVIEW

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.0</td>
<td>introduction</td>
<td>8</td>
</tr>
<tr>
<td>2.1</td>
<td>Five Competing Hypotheses</td>
<td>8</td>
</tr>
</tbody>
</table>
2.1.1 Temporary Price Effect 9
  2.1.1.1 Price Pressure Hypothesis 9
  2.1.2 Permanent Price Effect 11
    2.1.2.1 Downward Sloping Demand Hypothesis 11
    2.1.2.2 Liquidity Hypothesis 13
    2.1.2.3 Information Content Hypothesis 14
    2.1.2.4 Investor Awareness Hypothesis 15

2.2 Evidence on Malaysia Share Market 16

CHAPTER 3: RESEARCH METHODOLOGY

3.0 Introduction 17
3.1 The Sample 17

3.2 Event Study Methodology 18
  3.2.1 Event Date Specification 18
  3.2.2 Measuring Normal Return 20
    3.2.2.1 Market Model 21
  3.2.3 Measuring Abnormal Return 22
    3.2.3.1 Market Model 22
    3.2.3.2 Market Adjusted Model 22
  3.2.4 Measuring Average Abnormal Return 23
  3.2.5 Measuring Cumulative Abnormal Return 23
  3.2.6 Measuring Cumulative Average Abnormal Return 23
  3.2.7 Test of Significance 24

3.3 Hypothesis 25
CHAPTER FOUR: DATA ANALYSIS AND RESEARCH FINDINGS

4.0 Introduction 26
4.1 Measuring Abnormal Return 26
  4.1.1 Market Model 27
    4.1.1.1 Companies Included Into FBM 30 27
    4.1.1.2 Companies Remaining In FBM 30 29
    4.1.1.3 Companies Excluded From FBM 30 31
  4.1.2 Market Adjusted Model 33
    4.1.2.1 Companies Included Into FBM 30 33
    4.1.2.2 Companies Remaining In FBM 30 35
    4.1.2.3 Companies Excluded From FBM 30 36
4.2 Summary of Findings 37

CHAPTER FIVE: CONCLUSION

5.0 Introduction 38
5.1 Conclusion 38
5.2 Suggestion for Future Research 40

REFERENCES 41
LISTS OF TABLES

3.1 Table 1: Lists of companies included into, remaining in and deleted from FBM30

4.1.1.1 Table 2: Result of Test of Significance for companies included into FBM30

4.1.1.2 Table 3: Result of Test of Significance for companies Remaining in FBM30

4.1.1.3 Table 4: Result of Test of Significance for companies excluded from FBM30

4.1.2.1 Table 5: Results of Test of Significance for MAR - companies included into FBM30

4.1.2.2 Table 6: Results of Test of Significance for MAR - companies remaining in FBM30

4.1.2.3 Table 7: Results of Test of Significance for MAR - companies excluded from FBM30
LISTS OF FIGURES

3.2.1 Figure 1: Time Line for Event 1

3.2.1 Figure 2: Time Line for Event 2

4.1.1.1 Figure 3: CAAR for companies included into FBM30

4.1.1.2 Figure 4: CAAR for companies remaining in FBM30

4.1.1.3 Figure 5: CAAR for companies excluded from FBM30

4.1.2.1 Figure 6: CMAR for companies included into FBM30

4.1.2.2 Figure 7: CMAR for companies remaining in FBM30

4.1.2.3 Figure 8: CMAR for companies excluded from FBM30

LISTS OF ABBREVIATIONS

KLCI  Kuala Lumpur Composite Index

FTSE  Financial Times Stock Exchange

AAR   Average Abnormal Return

CAAR  Cumulative Abnormal Return

AD    Announcement Date

CD    Change Date
CHAPTER 1 INTRODUCTION

This chapter starts with background of the study under Section 1.0, and the introduction of FBM30 will be covered under Section 1.1, followed by the problem statement in Section 1.2. Research questions and research objectives are then covered under section 1.3 and 1.4 respectively. Significance of the study is discussed in section 1.5. Section 1.6 includes scope and limitation of the study. Finally the chapter concludes with the organization of the study in Section 1.7.

1.0 Background of the study

Bursa Malaysia is committed towards extending the Malaysian capital market’s global reach by offering competitive services and infrastructure through adoption of internationally accepted standards which are globally relevant. Kuala Lumpur Composite Index (KLCI) was enhanced to ensure that its robustness in measuring the national economy with growing linkage to the global economy. Bursa Malaysia have integrated the KLCI with internationally accepted index calculation methodology to provide a more investable, tradable and transparently managed index.

The KLCI is now known as FTSE Bursa Malaysia Composite Index and the enhancements were implemented on 6 July 2009. Compare with the KLCI which has 100 constituents, FTSE Bursa Malaysia Composite Index (FBMCI) comprises by only 30 largest stocks listed on the Main Board. Main board and second board merged to form main market. With the introduction of FBMCI, KLCI discontinued. According to Chan and Howard (2002), the shares of companies added to (deleted from) the closed-end indices such as the S&P 500 experience significant positive (negative) abnormal returns.
The contents of the thesis is for internal user only
References


**Website**

www.bursamalaysia.com.my