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

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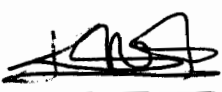*(Candidate for the degree of)* **MASTER OF SCIENCE (BANKING)**

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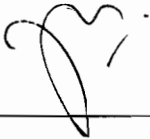
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ABSTRACT

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

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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.

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