

Wealth effects associated with announcements of hybrid securities and equity in an emerging country: Evidence from Malaysia

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Introduction

Extensive research has been carried out on wealth effects of security issues such as debt, equity and hybrid securities such as convertible debt. The latter securities have been the centre of attraction since these securities are unique in terms of having similar characteristics of debt and equity, not to mention for being ‘back door equity’ and ‘debt sweetener’. At an early stage, the study of market reactions towards announcement of convertible bond has been the focus in the United States (i.e. Dann and Mikkelson, 1984; Eckbo, 1986; Mikkelson and Partch, 1986; Janjigian, 1987). Later the research expanded to Japan (i.e. Kang, Kim, Park and Stulz, 1995; Christensen, Faria, Kwok and Bremer, 1996), the Netherlands (De Roon and Veld, 1998), United Kingdom (Abhyankar and Dunning, 1999), France (i.e. Burlacu, 2000; Gillet and De La Bruslerie, 2008), Germany (Gebhart, 2001), Western Europe (Dutordoir and Van de Gucht, 2007), Canada (Loncarski, Ter Horst and Veld, 2006), Australia (Suchard, 2007; Arsiraphongphisit, 2008), China, (Li and Wang, 2008), Taiwan (Chang, Chen and Liu, 2004), and Malaysia (Mohd Ashhari and Sin-Chun, 2009). The wealth effects to announcement of convertible bond for different countries also indicate mixed results. Most of United States studies reveal negative abnormal returns and some country such as Japan and the Netherlands reveal positive abnormal returns.

Empirical evidences reject the fact that differences in corporate structure (such as market-oriented system and network-oriented systems) will contribute to differences in wealth effects of convertible bonds (i.e. De Roon and Veld, 1998; Kang et al., 1995; Kang and Stulz, 1996). However, Korkeamaki (2005) highlights that difference in legal systems (such as common law or civil law) will contribute to difference design of convertible bond. Countries that have weak shareholders protection will design their convertible bond to be debt-like whereas countries that have weak creditor protection will design their convertible bond to be equity-like.

Nevertheless, empirical evidence also confirms that even in the similar financial structure, the market reaction towards the choice of flotation methods are not the same. In the United States, the market reactions towards season equity offerings through firm-commitments indicate more negative abnormal returns compared to rights offering (Heinkel and Schwartz, 1986; Eckbo and Masulis, 1992). Despite the more negative market reactions and higher issuance cost as compared to rights issue, firm-commitments in United States are more popular than rights issue and placement are very rare. Kothare (1997) justify that not only rights offering increased the concentration of ownership and public offerings diffuse the ownership, rights offering also have indirect cost as it reduce the liquidity of the stock. Eckbo and Masulis (1992) also note the possible trade-off between rights and underwritten offers, in which investors consider rights issue as a direct sale to public if the existing shareholders do not take-up whereas view underwriter cost as a participation of current shareholders in the issue, consequently reduce the adverse-selection cost. The researchers also describe that increased dispersion in share ownership in the United States would be a possible explanation for this paradox. United States evidence in private placement of convertible bond, which is

equivalent to pure placing in United Kingdom, reveals the same market reactions to United Kingdom, positive abnormal return of 1.8% significant at the 5% level (Fields and Mais, 1991).

While in United Kingdom, season equity issuance through placing which have quite similar characteristic to firm-commitment offerings in United States reveals positive abnormal returns (Slovin, Sushka and Lai, 2000; Barnes and Walker, 2006; Armitage and Snell, 2001). Although firm-commitment is a form of public offerings, the shares are also sold by negotiation with potential buyers during bookbuilding and places are rewarded (Armitage and Snell, 2001, pp.40). Slovin et al. (2000) justify besides having the opportunity to modify ownership structure, to be more dispersion, the positive market reactions to placing is also due to the underwriter certification. Later, Armitage (2002) confirms that underwriter certification is not a variable that lead to positive market reactions to placing but the willingness of the investors to buy the shares that signal the firm's value to the market might be the possible explanation.

Armitage and Snell (2001) conclude that in placement, potential investors who normally buy large blocks of shares have the opportunity to investigate the true value of the issuer. They also suggest that regulations formed by London Stock Exchange that stop the fixed brokerage commission and takeovers by bank to form more capital, consequently make the trading in large blocks cheaper, also play a prominent role for the growth in placements at United Kingdom. The direct cost of issuing secondary equity in United Kingdom also less than United States since in the latter market discount are not important (Armitage, 2000). The earlier research by Burton, Lonie and Power (1999) also find that a strong significant negative (at 5% level) of -8% abnormal returns to rights issue and non-significant negative -1% abnormal returns for non-right issues. Burton et al. (1999) suggests that the more negative reactions to rights issues is due to the perception of outside investors that the issuance of secondary equity is similar to issuance of primary equity in which the objective is to increase the shareholders wealth through over-priced shares.

In other market-oriented system countries, most of the rights issue of equity reveal negative abnormal returns, to name a few: Australia (Arsiraphongphisit, 2008; Balachandran, Faff and Theobald, 2008), and for convertible bonds: Suchard (2007) in Australia. Empirical evidence of season equity offerings in emerging countries is also inconclusive. For Malaysia and Singapore, price behaviour of rights offering document positive market reactions (Salamudin, Ariff and Nassir, 1999; Tan, Chng and Tong, 2002). The main reason for the positive market responds to the rights offerings in these countries is because of the investors' perception that the fund will be used for capital expenditure or for more investment opportunities. In Indian market (Marisetty, Marsden and Veeraraghavan, 2008), non-significant positive abnormal return to rights issue is observed. Interestingly firms with higher levels of individual shareholding contribute to positive abnormal returns whereas firms with high family affiliation contribute to negative abnormal returns. Chen and Chen (2007) document significant negative abnormal returns for rights issues in China market and conclude that higher legal person subscription ratio do not improve the firm's performance in the long run. In the Netherlands, Kabir and Roosenboom (2003), also report significant negative abnormal returns to rights issue and observe that the decline in five years post operating performance after the rights offerings consequently suggesting that the market reactions to announcements of rights issues can predict firm's future operating performance.

Research Questions

The mixed results of the price behaviour of issuance of securities are an interesting topic to study especially in emerging country as Malaysia. Despite the fact that there are an event study on announcements of convertible bonds versus straight bond in Malaysia (Mohd Ashhari and Sin-Chun, 2009), rights issue (Salamudin et al., 1999), private placement (Mohamad et al., 2007), this propose study try to merge all those three study, validate as well as to tell the whole story about Malaysia capital market. To combine the securities such as hybrid securities and equity through rights offering and private placement in emerging market such as Malaysia allow us to study the whole capital market itself.

Therefore, the purpose of this study is to answer a few questions:

- 1) What is the market reaction to announcement of convertible debt and equity through rights issue and placing in Malaysia?
- 2) What factors influence listed firms in Malaysia to choose convertible debt instead of straight debt and Islamic debt?
- 3) What determine issue method choice for listed firms in Malaysia? Do variables tested in Barnes and Walker (2006) which is characteristic of the market, characteristics of issuer and the issue as well as ownership structure and management control dimension influence the decision of issue method choice for the listed firms in Malaysia?

Why Malaysia?

Malaysia is known as an emerging market which is quite small. At the end of 2008, net funds rose in the capital market both from public and private sector was only RM56,302 million with RM36,188 million from public sector and RM20,114 million from private sector. Convertible bonds contribute to RM846 million. Nevertheless, the development of capital market in Malaysia has changed significantly especially for bond market. Chan, Ahmad and Wooldridge (2007), comment that private debt securities (PDS) market in Malaysia is the most advanced in Asia. Their technology is quite advanced as compares to other Asian countries. Real Time Electronic Transfer of Funds and Securities System (RENTAS) is being used so they can settle all transactions in two days after the trade. Securities Commission of Malaysia is in charged of all the private debt securities either conventional or Islamic securities while Bank Negara Malaysia is in charged of all the government bonds either conventional or Islamic securities. This study will contribute to the body of literature emphasizing on emerging economic especially on hybrid securities as well as equity offering through rights issue and private placement.

Malaysia also has a unique capital market with two corporate bond markets, to be exact conventional bond markets and Islamic bond markets. The issuance of Islamic bond has been dominated the conventional debt significantly. At the end of 2008, Islamic bonds contribute to RM7,468 millions which is more than half of issuance of straight bonds. It is interesting to know how the market reacts towards the announcement of convertible bond and why company in Malaysia issue convertible bond in the presence of sukuk, the Islamic bond.

Mohamad et al. (2007) note that share market in Malaysia could be considered as the ten most liquid among emerging market in the world and confirm that capital market in Malaysia behave much closer to developed markets (pp.173). Therefore, market reaction to announcements of convertible bonds in Malaysia is expected to have negative impact as

predicted in develop markets. In addition, the announcements of rights issues in Malaysia is expected to have negative impact while the private placement is expected to have positive impact.

Methodology

Announcements dates of convertible bonds issuance, the rights issues and the private placements will be hand collected from Investors Digest from 1996 to 2004 and for 2005 to 2009 will be taken from Bursa Malaysia website. The daily prices and firm's characteristic data will be collected from DataStream. This event study will be conducted as a standard event study procedure proposed by Brown and Warner (1985). Since capital market in Malaysia suffer from thin trading, beta adjustment is needed as proposed by Strong (1992).

The propose duration of the study of announcements of convertible bonds, rights issue and private placement is from 1996 to 2009. Regression analysis is used to find relationship between factors that influence firms to issue hybrid securities. Meanwhile, logit regression analysis is used to find relationship between rights issue and private placement with the variable that influenced issue method choice. Dependent variable equal to 1 if issue method is rights issue and 0 if the issue method is private placement.

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