



UNIVERSITI PUTRA MALAYSIA

**THE EFFECTS OF PRIVATE PLACEMENTS ANNOUNCEMENT ON
SHAREHOLDERS' WEALTH AND TRADING VOLUME**

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By

NORMAZIAH BINTI MOHD NOR

**Thesis Submitted to the Graduate School of Management,
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This study examines the reaction of the stock price and the volume of trade surrounding the announcements of private placements in Malaysia. The wealth effects of private placements announcements over different economic conditions are examined based on different use of proceeds from the placement exercise, and different use of premium and discount in offer prices. Apart from studying the wealth and trading volume effects, the research in this study is extended to identify factors, which explain the price behavior of private placement announcements.

This study used the event study methodology to measure the price behavior of private placements and the multivariate analysis is used to determine the variables explaining price behavior. The market-adjusted return method is employed to derive abnormal returns of private placement announcements. The analysis is conducted on 46 announcements of private placements for the period 1994 to 2003.

The wealth effects, as measured by cumulative average abnormal returns (CARs), surrounding private placement announcements showed a pattern which is consistent with the findings in developed markets (Hertzel and Smith, 1993 and Wruck, 1989). The findings show significant positive wealth effect before the announcement day. The CAR for the period prior to the announcement date, $CARs(-10,-1)$, is significant at 3.05 percent and statistically significant at 5 percent level. A reasonable explanation for these positive returns is the occurrence of information leakage prior to the announcement day.

However, the average abnormal return (AAR) on the announcement date, $AAR_{(t=0)}$, is found to be negative (-0.63 percent) and it is statistically significant at 10 percent level. This is contrary to the evidence shown in the US but is consistent with the evidence in the Singapore market (Chen et al., 2002). It is possible that the negative returns are due to either market over-reaction or profit taking transactions by speculators who had traded on superior information before the announcement day.

The results show that the cumulative abnormal returns (CARs) associated with private placements differs significantly across economic conditions at the time of issuance. The price reaction of Malaysian firms to private placement is sensitive to economic conditions at the time of the private placements. Private placements typically result in significantly negative CARs during economic downturns and significant positive CARs during economic growth.

In addition, significant negative announcement reaction was observed when private placement proceeds are allocated for new project investment compared to the positive reaction for proceeds allocated for debt repayment and working capital requirements.

The average volume of trade increases significantly for the entire analysis period. Private placements spark a large increase in trading activity during economic growth (before announcement day), during economic downturn (after announcement day), and when there are discounts in offer price sample and when funds are used for debt repayment.

In the multivariate analysis of cumulative abnormal return (CAR) for each company with the determinants, it is found that offer price premium, book to market value ratio, proceeds to repay the debt, and the company's size provide statistically significant explanations of the variation in CAR. However, this study finds that the relative size of issues of private placement cannot explain the variation in CAR.

Overall, the findings support the information signaling hypotheses, the wealth transfer hypotheses, the price pressure hypotheses, the firm quality hypotheses, and the information asymmetry hypotheses. However, there is no evidence to support investment opportunities argument effect. Private equity placements in Malaysia exhibit a strong positive relationship between abnormal returns and the price premium at which the shares are placed. The relationship suggests that placement price provides important information regarding a firm's quality and value.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi sebahagian keperluan untuk ijazah Master Sains

**KESAN PENGUMUMAN PERLETAKAN PERSENDIRIAN KE ATAS
KEKAYAAN PEMEGANG SAHAM DAN JUMLAH DAGANGAN SAHAM**

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Kajian ini bertujuan untuk mengkaji kesan pengumuman perletakan persendirian ke atas harga dan jumlah dagangan saham di Malaysia. Kajian ini juga mengkaji kesan kekayaan pelabur ke atas pengumuman perletakan persendirian berdasarkan kepada keadaan ekonomi yang berbeza ketika pengumuman dibuat, tujuan terbitan perletakan persendirian dan juga dikaji berdasarkan harga diskaun dan premium dalam harga tawaran. Selain daripada mengkaji kesan kekayaan dan jumlah dagangan, kajian ini diperluaskan untuk mengenalpasti faktor-faktor yang dapat menerangkan kelakuan harga semasa pengumuman perletakan persendirian dibuat.

Lakaran penyelidikan yang digunakan dalam kajian ini ialah metodologi peristiwa kajian untuk mengukur kelakuan harga saham dan analisis pelbagai pembolehubah (*multivariate analysis*) digunakan bagi menentukan faktor-faktor yang mempengaruhi kelakuan harga saham. Kaedah pulangan pasaran terlaras pula digunakan untuk memperolehi pulangan abnormal daripada pengumuman perletakan persendirian. Sebanyak 46 pengumuman perletakan persendirian bagi tempoh 1994 hingga 2003 dikaji.

Keputusan kesan kekayaan pelabur terhadap pengumuman perletakan persendirian di Malaysia yang dikira melalui purata kumulatif pulangan abnormal (CAR) menunjukkan keputusan yang konsisten dengan negara maju. Keputusan menunjukkan kesan positif yang ketara terhadap kekayaan pelabur sebelum tarikh pengumuman dibuat. Purata kumulatif pulangan abnormal, $CAR(-10,-1)$ sebelum hari pengumuman ialah 3.05 peratus dan signifikan pada paras 5 peratus. Kesan pulangan positif ini disebabkan oleh kebocoran maklumat yang telah terjadi sebelum hari pengumuman.

Namun begitu, purata pulangan abnormal (AAR) pada hari pengumuman, $AR_{(t=0)}$ adalah negatif (-0.63 peratus) dan ianya signifikan pada paras 10 peratus. Walaupun penemuan ini tidak selari dengan negara maju, Amerika Syarikat, tetapi ianya konsisten dengan penemuan di pasaran Singapura. Pulangan negatif pada hari pengumuman mungkin disebabkan oleh reaksi pasaran yang melampau ataupun disebabkan oleh pengambilan untung oleh spekulator yang beurusniaga dengan maklumat yang didapati sebelum hari pengumuman.

Jumlah purata kumulatif pulangan abnormal (CAR) kesan daripada pengumuman perletakan persendirian adalah berbeza bergantung kepada keadaan ekonomi semasa pengumuman dibuat. Kelakuan harga saham bagi pengumuman perletakan persendirian oleh syarikat di Malaysia adalah sensitif terhadap keadaan ekonomi semasa. Perletakan persendirian memberi pulangan besar bererti yang negatif sekiranya pengumuman dibuat ketika ekonomi kurang baik dan memberi pulangan positif bererti ketika ekonomi berkembang.

Tambahan daripada itu, reaksi negatif dikenalpasti sekiranya pengumuman perletakan persendirian bertujuan untuk pelaburan baru berbanding reaksi positif sekiranya perletakan persendirian itu digunakan untuk tujuan pembayaran hutang dan keperluan modal bergerak.

Jumlah dagangan purata juga meningkat di sepanjang tempoh analisis. Jumlah transaksi meningkat sekiranya perletakan persendirian dibuat dalam keadaan ekonomi kurang baik (selepas hari pengumuman), dalam keadaan ekonomi baik (sebelum hari pengumuman), premium di dalam harga tawaran dan bertujuan untuk pembayaran hutang.

Daripada analisis pembolehubah, faktor-faktor yang dapat menerangkan kelakuan harga semasa pengumuman perletakan persendirian dibuat ialah premium di dalam harga tawaran, nisbah nilai book kepada nilai pasaran, perletakan persendirian untuk tujuan pembayaran hutang dan saiz syarikat. Walaubagaimanapun, relatif saiz tawaran perletakan persendirian tidak dapat menerangkan variasi di dalam CAR.

Secara keseluruhannya, penemuan kajian ini menyokong hipotesis isyarat maklumat (*information signaling hypothesis*), hipotesis pemindahan kekayaan (*wealth transfer*), tekanan harga (*price pressure hypothesis*), hipotesis kualiti syarikat (*firm quality*) dan hipotesis informasi asimetri (*information asymmetry*). Walaubagaimanapun, tidak ada penemuan untuk menyokong bukti kesan daripada peluang pelaburan (*investment opportunities*). Perletakan persendirian di Malaysia menunjukkan hubungan positif pulangan abnormal dengan harga tawaran. Perhubungan itu menerangkan bahawa harga perletakan persendirian memberi maklumat penting berkenaan dengan nilai dan kemampuan syarikat.

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LIST OF ABBREVIATIONS

AAR	Average Abnormal Return
AAV	Average Abnormal Volume
BNM	Bank Negara Malaysia
CAV	Cumulative Abnormal Volume
CAR	Cumulative Abnormal Return
GDP	Gross Domestic Product
ESOS	Employee Share Option Scheme
ICULS	Irredeemable Convertible Unsecured Loan Stock
IPO	Initial Public Offering
KLCI	Kuala Lumpur Composite Index
KLSE	Kuala Lumpur Stock Exchange
MESDAQ	Malaysian Exchange of Securities Dealing and Automated Quotations
NDP	National Development Policy
NPV	Net Present Value
NVP	National Vision Policy
OLS	Ordinary Least Square
PN17	Practice Note 17
PN4	Practice Note 4
SC	Securities Commission
SEO	Season Equity Offering
US	United States

CHAPTER 1

INTRODUCTION

1.1 Background

This study examines the Malaysian stock market reaction to announcements of seasoned equity offering and to identify the relevant factors that explain the associated price reactions. A seasoned equity offering (SEO) is a new issue for company with securities that have been previously listed. In Malaysia, a seasoned equity offering is typically undertaken by way of rights issue, private placement and special issue. In the case of rights issue, existing shareholders are granted pre-emptive rights to purchase the new issue shares of the listed firm. In a private placement, new shares are sold to selected institutions or high net worth individuals. Whereas in a special issue, *Bumiputra* institutions and individuals are given a special issue of shares at a price lower than the market price for the purposes of compliance with National Development Policy (NDP) or National Vision Policy (NVP) requirements.

Unlike the developed markets, the documented evidence on the effects of seasoned equity in the emerging stock market like the Malaysian stock exchange (Bursa Malaysia) is based on rights issues and there is very little evidence on private placements as a significant source of raising capital. After the crisis, in year 1999 private placements accounted for more than 80 percent of the total funds raised in that year. Thus, private placement is still an important source of capital formation in the Malaysian equity market.

The market response to news of seasoned equity offerings differs substantially across countries or markets. In developed capital markets with large ownership dispersion like

U.S., stock price reaction is negative for rights issue and positive for private placement. In countries with less developed capital markets and large ownership concentration such as Greece, Italy, Korea, Singapore and Turkey the reaction to rights issue announcement is consistently large and positive (Ariff, 2004). Eckbo and Masulis (1992) document that rights issue in the United States reported statistically significant negative abnormal returns. Loderer and Zimmerman (1988) investigated rights issues in Switzerland and reported insignificant average abnormal returns, as did Smith (1977) in the United States. On the contrary, Kang (1990) showed significant positive abnormal returns for rights issues in Korea and Ariff and Finn (1989) found positive abnormal returns in Singapore.

Studies in the United States by Wruck (1989) and Hertz and Smith (1993) showed that private equity placement announcement in the United States are associated with a positive market reaction, which is in direct contrast to evidence on rights issue in the United States. Similarly, studies in New Zealand by Anderson, Rose and Kahan (2006) and in Singapore by Tan, Chng and Tong (2002) showed that the share price reaction to private placements is significantly positive. Wruck finds that there is a significant increase in ownership concentration following a private placement and that the change in ownership concentration can partially explain the positive announcement effect. Hertz and Smith show that the positive stock price reaction reflects favorable inside information about firm value. Anderson et al. (2006) and Tan et al. (2002) find that the abnormal returns are positively related to the placement price.

There is no documented evidence on private placements in emerging market like Malaysia. Because of the inconclusive evidence on the wealth effects of the seasoned equity offering (SEOs) in developed and developing market, this study examines the

stock market's reaction to equity private placements in an emerging market, Malaysia. Examining private placements in a different market environment significantly substantiate evidence on market reaction to private placements announcement in an emerging market.

1.2 The development of Malaysian seasoned equity market

Malaysian economy has been enjoying a steady growth from 1970 to mid-1990s, before the onset of financial crisis in 1997. Known as one of the “Asian Tigers”, its economy has been one of the best performers in the Asian region for those past three decades. The inflation was low, interest rates and the exchange rates were generally stable, with an average annual economic growth rate of more than 8 percent for three decades.

During the growth period, there were many investment opportunities available to Malaysian firms. And funds required to expand the business were readily available from commercial banks at a relatively low interest rate. The Malaysian firms were successful in riding on the boom while it lasted. However, the financial environment changed after the crisis. The private sector experienced difficulties securing funds because (i) interest rate increased, (ii) commercial banks faced liquidity problems, (iii) bearish equity market made it difficult for companies to float new shares, and (iv) offshore loans became costly due to currency depreciations and low rating of the company or stringent regulatory requirements.

The financial crisis revealed that Malaysian firms had high leverage, insufficient capitalization, poor risk-management capabilities, and substantial counterparty exposures that made it difficult to manage the fallout from the crisis. Due to high percentage of Non

Performing Loans (NPL's), the commercial bankers' loan criteria were tightened after the crisis and corporate firms had to search for alternatives means to secure investment capital.

Descriptive statistics on sources of investment capital raised over the years summarized in Table 1 show that in commensuration with the improvement in the economy, corporate debt and new equity issuance has since increased substantially as a source of funds in the market. One of the most notable changes in Malaysian corporate finance after the crisis was the high growth of new equity and corporate debt securities issuance. Indeed, since 1992, equity issuance has continued to account for more than 39 percent of external funds although borrowings from banking institutions were the major source of external funds until 1998.

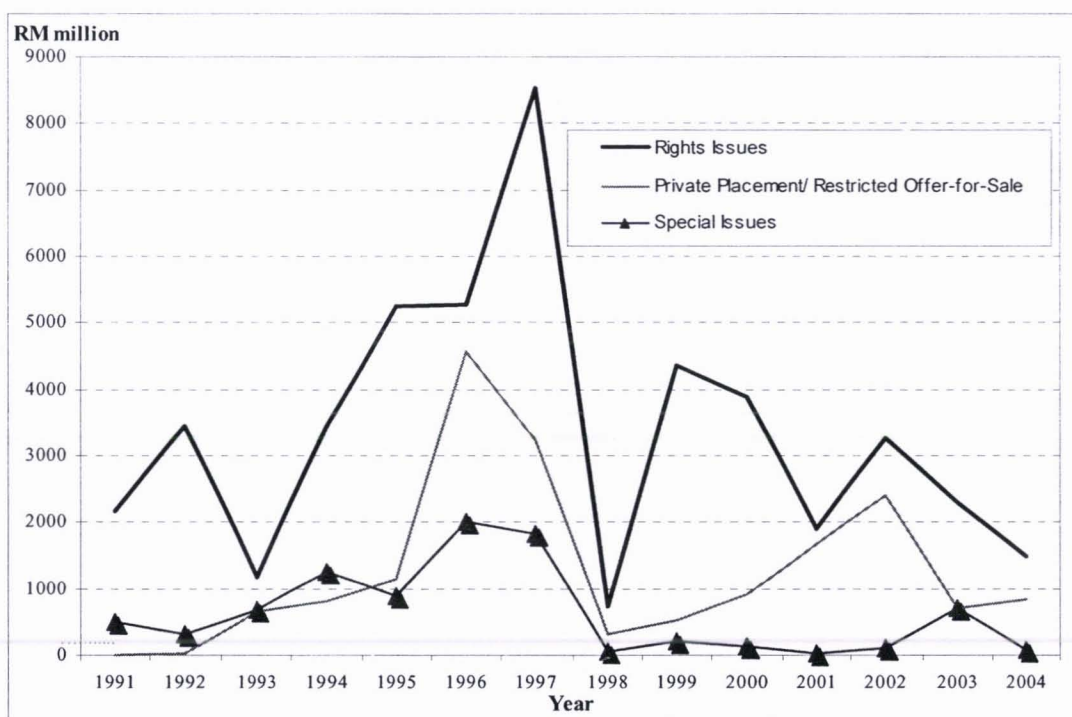
The equity market has contributed to the development of the private sector, with initial public offerings (IPOs) and issuances of seasoned equity enabling many companies to obtain relatively cheap financing. Equity investments by individual, institutional, and foreign investors increased substantially, and market infrastructure was developed to accommodate the growth. Computerized trading, electronic clearing and settlement, and central depository systems were in place by the end of 1997.

Table 1 shows that in year 1996 and 1997 private placement contributed about 14 percent and 10 percent of net fund raised respectively in the Malaysia capital market. During the financial crisis years the percentage of private placement to net funds raised in capital market declined to 2 percent and increased again to 10 percent in 2002 and thereafter

declined again to 2 percent in 2004. In 2002 the Malaysian economy became more stable and private placements once again became the significant source of corporate funding.

As shown Figure 1, in the biggest contributions in the seasoned equity offering (SEO) in Malaysia from year 1992 to 2004 were from rights issue and private placements. Private placements become significant source of funds after 1993. However, the fund received from SEOs on the Bursa Malaysia decline significantly from RM 13.6 billion in 1997 to RM 1.1 billion in 1998 due to the economic crisis but increased to RM 5 billion in post crisis period.

Figure 1: Seasoned equity offerings (SEOs) in Malaysian capital market: 1991-2004



Source: Bank Negara Malaysia, <http://bnm.gov.my>

Table 1: Development of seasoned equity offerings (SEOs) and private placements in Malaysian capital market: 1991-2004

RM million

	BY PUBLIC SECTOR	BY PRIVATE SECTOR							Net Funds Raised in the Capital Market	Total seasoned equity offering ³	% of private placement to new issues of shares	% of private placement to Seasoned Equity Offering	% of private placement to Net Funds Raised in the Capital Market
Year	Net Funds Raised by the Public Sector	Ordinary Shares ¹				New Issues of Shares ²	Net Issues of Debt Securities	Net Funds Raised by the Private Sector					
		Initial Public Offers	Rights Issues	Private Placement/ Restricted Offer-for-Sale	Special Issues								
1991	3157.0	1710.9	2157.7	-	490.8	4391.4	1872.9	6264.3	9421.3	2648.5	-	-	-
1992	1530.5	5415.8	3437.8	27.5	300.4	9181.5	3324.4	12505.9	14036.4	3765.7	0%	1%	0%
1993	1180.5	912.7	1176.9	658.8	684.2	3432.6	3639.8	7072.4	8252.9	2519.9	19%	26%	8%
1994	1778.2	2972.9	3436.7	798.9	1249.4	8457.9	9032.6	17490.5	19268.7	5485.0	9%	15%	4%
1995	-35.2	4175.0	5240.2	1146.9	875.5	11437.6	8338.6	19776.2	19741.0	7262.6	10%	16%	6%
1996	1331.1	4099.2	5268.5	4554.4	2002.3	15924.4	14533.7	30458.1	31789.2	11825.2	29%	39%	14%
1997	-1407.2	4781.0	8524.9	3233.6	1818.8	18358.3	16784.0	35142.3	33735.1	13577.3	18%	24%	10%
1998	9803.7	684.6	722.0	320.1	61.0	1787.7	6175.3	7963.0	17766.7	1103.1	18%	29%	2%
1999	6297.3	1009.2	4346.9	518.6	208.0	6082.7	15026.0	21108.7	27406.0	5073.5	9%	10%	2%
2000	13659.2	992.3	3898.5	912.0	126.1	5928.8	19935.9	25864.7	39523.9	4936.6	15%	18%	2%
2001	15214.1	1677.9	1891.8	1680.6	32.9	5283.2	17577.3	22860.5	38074.6	3605.3	32%	47%	4%
2002	8568.0	6834.9	3271.2	2401.6	92.1	12599.8	2058.2	14658.0	23226.0	5764.9	19%	42%	10%
2003	23851.0	3952.2	2282.7	707.2	691.6	7633.7	18730.5	26364.2	50215.2	3681.5	9%	19%	1%
2004	26671.3	4016.7	1494.4	838.0	68.0	6417.1	9525.8	15942.9	42614.2	2400.4	13%	35%	2%

¹ Excludes funds raised by the exercise of Employee Share Options Scheme, Transferable Subscription Rights, and Irredeemable Convertible Unsecured Loan Stocks.

² Exclude warrants

³ Seasoned Equity Offering = Rights issue + private placement + special issue

Source: www.bnm.gov.my

1.3 Problem statement

When the listed companies make announcements either regarding the issue of new share or any other form of announcement that convey material information, the stock price will react positively or negatively depends on the perception of the market regarding announcements as unfavorable or favorable news. Favorable news will lead to increase in share prices or returns and therefore will have positive wealth effect. Unfavorable news will have a negative wealth effect. There is ample documented evidence on the wealth effect of announcements of various types of events in the finance literature. Initially event studies were undertaken to examine whether the market were informationally efficient, in particular, the speed of adjustment or how fast the newly announced information was incorporated in share price. The empirical evidence on the seasoned equity offering is inconclusive. Scholes's (1972) study on the rights issues in U.S reports positive price reaction. However, White and Lusztig (1980), Hansen (1988), Eckbo and Masulis (1992), and Bae and Jo (1999) report statistically significant negative abnormal returns surrounding rights issue announcements in the United States. Loderer and Zimmerman (1988) investigated rights issues in Switzerland and reported insignificant average abnormal returns as did Smith (1977) in the United States.

In countries with less developed markets and large ownership concentration as Greece, Italy, Korea, Singapore and Turkey the reaction to rights issue is relatively large and positive. Ball, Brown and Finn (1977), Berglund, Liljeblom, Wahlroos (1987), Kang (1990), Tsangarkis (1986), Bohren, Eckbo and Michalsen (1997) provide evidence of positive price effect around rights issue announcements in Australia, Finland, Korea, Greece, and Norway, respectively.

In United States, Wruck (1989) and Hertz and Smith (1993) showed that private equity placements are associated with a positive market reaction. Similarly, in Japan, Kato and Schallheim (1993) showed that the share price reaction to private placement is significantly positive. Tan et al. (2002) also documents positive announcements effects for both rights issue and private placements in Singapore for the period 1987-1996. However, Chen et al. (2002) had examined private equity placements in Singapore from year 1988 to 1993 in a different regulatory environment and found negative announcement returns in the two-day announcement period and a reduction in ownership concentration.

The finding on market reaction to private placement in developed market is mostly reported positive reaction but in less developed market is inconclusive. In Malaysia, to date there is no documented evidence on private placements, despite the fact that private placements are an important source of investment capital on the KLSE (Figure 1) that has helped in the nation's economic growth.

Therefore, it is imperative that a comprehensive study on the Malaysian stock market reactions to private placements announcements is carried out to provide some insights to investors, entrepreneur, financial managers, financial intermediaries and regulators or policy makers understand the market for private placements in Malaysia.

In a private placement, it assumed that investor would only invest in a company that is financially healthy and has great growth opportunities. This kind of investment will promise a positive abnormal return to its investors. Therefore, the company is welcome to loan from large and strong firm due to the expected future business growth opportunities.