UNIVERSITI PUTRA MALAYSIA

THE WEALTH EFFECT OF THE SECURITIES COMMISSION AND THE CENTRAL BANK ANNOUNCEMENT

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ABSTRACT

This study examined the effect of events announcement by The Securities Commission and The Central Bank on the Kuala Lumpur Stock Exchange Composite Index and Sectoral Indices. The data and information on the event announced and market index was obtained from the Kuala Lumpur Stock Exchange Library, newspaper reports, etc. The period of study was from March 1, 1993 to August 31, 1997 for The Securities Commission event announcement, whereas for The Central Bank Event announcement, the period was from January 1, 1994 to February 28, 1994.

An event study method was employed to estimate the market return and average return. The statistical significance of the average return were ascertained at 5 percent level. A sample of 16 events for The Securities Commission and a sample of 7 events for The Central Bank were analyzed.

The findings showed that there was no evidence of significant abnormal returns due to the events announced by The Securities Commission. This implies that events announced by The Securities Commission are of non-event and no 'news' to the market (Composite Index).

For the events announcement by The Central Bank, the finding showed some evidence of significant average returns both on the Composite Index and Sectoral Index (Finance Sector). This means the event announcement by The Central Bank are considered 'news' to the market.

An interesting point to note is that, The Central Bank's announcement were leaked to the market a week before the announcement.

In conclusion, though the general events announcement by the authority were no 'news' to the market, the specific event announcement by the authority are considered 'news' to the market and market will react accordingly towards the information content of such specific event announcement. An interesting point noted was the leakage of early information prior to the event announcement.

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INTRODUCTION

1.1 Introduction

The purpose for a firm to be listed in the stock market is to gain and to mobilise the funds from the market and public to finance their corporate investment and expansion program, as well as in the ownership transfer and shareholders structure changing of the companies.

Generally, listing helps to increase the marketability and hence the value of the firm. This is because the shares are spread amongst many shareholders and investors are looking to purchase the shares, if purchase demand is greater than stock supply then the stock price will go up and vice versa. Therefore, the value of the stock will be reflected in the stock price in the market, the higher the price, the higher the value.

However, shares are a much riskier form of investment, although the fact that the return on a stock investment has the potential of increasing, it also can cause losses to investors. Hence, the investor must make an inaugural judgement when making investment in the share market. The golden rule is to purchase a stock when its market price is well below its intrinsic value and to sell it when its price is well above its intrinsic value.

Economists believed that the investors generally behave "rationally" when investing, whether to buy or to sell the stocks. They are presumed to use all available information to form their "rational" expectation about the potential price of stock and the value of the firm. But, in reality, there are many and various issues that will affect the stock price and the value of the firm. Hence the investment decision is also influenced by issues, such as the announcement of firm's business activities that are of economic importance, before and after the announcement of each event that is perceived would have effect on the price of the stock.

The study of effect of firm's business activities announcement towards the price of shares has been getting wide attention in the literature. This business activities announcement is regarded by the corporate world as means for growth, diversification or host of other motives and have the subjects of great interest worthy of further research.

The Malaysian Capital market is no exception, there are a number of research that have been carried out by researchers in relation to the event announcement by the firms on their business activities. The stock prices reaction towards the announcement of an event can indicate whether the market considers the event significant. The effect can be positive or negative, depending on how the market view the announcements. Markets are the best judge for the significance of an event, though they can be wrong sometimes, but they are right most of the time.

1.2 What Is Event Study ?

Event study is an analysis of market index and security price behaviour around the time of an event of economic importance. There are two types of event that are expected to have a significant impact on the price and changes in index, that is the event that originates from the internal and external of the firm. Any announcement of earning reports, takeover/mergers, assets acquisitions, appointment/resignation of directors/Chief Executive Officer (CEO), introduction of new products/production are examples of events from within the firm. Whereas any changes in authority policies and government regulations relating to business firms or the current account deficit/surplus in the economy, the policy, regulations and measures to control the credit situation, are examples of events from outside the firm.

In this study, events from external of the firm will be identified and analysed. That is the events that are announced by The Securities Commission (Appendix I) aimed at enforcing the requirement of The Securities Commission Act 1993 or to regulate the smooth running of the Securities Industry particularly the Kuala Lumpur Stock Exchange. Another type of event announcement that will be studied is the event announcement by The Central Bank of Malaysia (Appendix II) that aimed to curb or to check the inflows of speculative funds including foreign short term funds so as to stabilise the credit situation of the country.

All such event announcement by The Securities Commission and The Central Bank are perceived to have certain effect on the general market and individual stock prices as well.

The reaction of such effect by the market establish the significance of the measures taken by both authorities in achieving their objectives.

1.3 Market Reaction Toward The Event Announcement

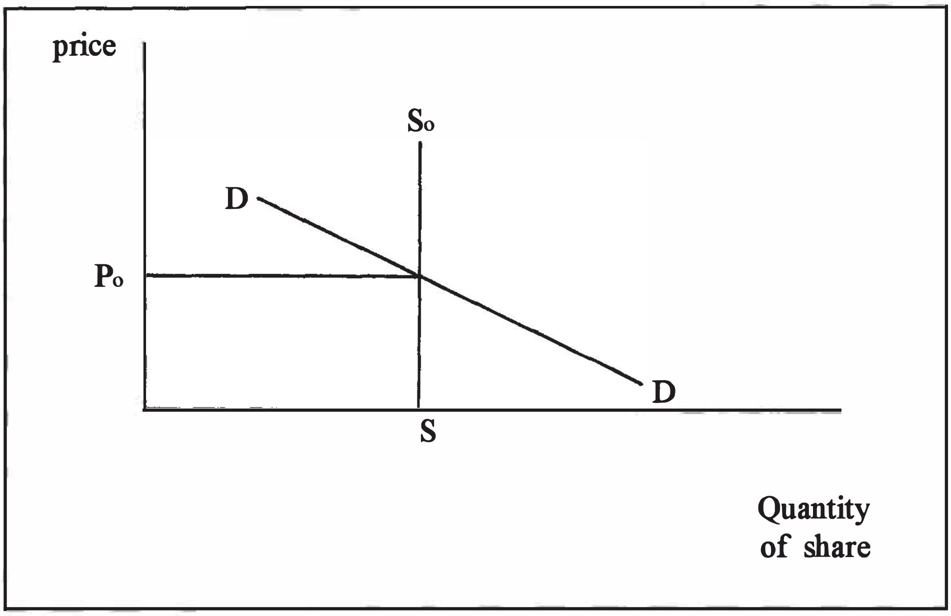
The stock prices and market sentiments is expected to show reaction towards all the information content of events announcement whether emanating from the firm or outside the firm. The magnitude and direction of reaction will depend on perception of the market about the event, if the market perceive that the event is expected to improve the market or financial opportunities, then investors will react positively and might even purchase the stock. Conversely, if the market views that the event is an unfavourable news, that will create selling pressure on the price of the shares.

1.4 Stock Price Determination In The Market

The market price of a stock, just like all other economic goods, is a function of supply and demand. When the demand of stock is greater than supply of stock, the stock price will increase and vice versa. The total demand of stock depends on the price at which it could be bought. At high prices, only those that are optimistic are willing to hold the stock, hence, the demand is small. But, at low prices, the demand for stock would increase. However, there are always differences of opinion about the stock's future prospects, that is the down-ward-sloping demand curve, as shown in Figure 1.1.

The equilibrium price of the stock is at P_o, at P_o, the total desire to own the stock is equals to the outstanding supply. At prices that are higher than P_o, investors desire to hold only small number of shares and at this point, the attempt by investors and speculators to sell stock will drive the price down to P_o again. If the prices are lower than P_o, the attempts to purchase stock by investors and speculators will drive the price up again.

Figure 1.1: The Stock Price Determination In The Market



Note: DD - Demand For Share Curve
SSo - Supply Of Share Curve

The equilibrium price, and thus the market trading price, will also change when, if there are new information enters the market to cause a shift in the demand curve or if there is a shift of the quantity supply changes (Assuming investors have diverse opinion).

1.5 The Stock Valuation Model

The most widely and commonly used stock valuation model is the Dividend Valuation Model. In this model, the intrinsic worth of a stock is estimated by discounting all the future expected dividends per share at a return that depends upon the stock's risk. The value of the stock in the General Dividend Valuation Model are:

$$P_o = \frac{D_1}{1+K_1} + \frac{D_2}{(1+K_1)(1+K_2)} + \text{------} + \frac{D_N}{(1+K_1)(1+K_2)\text{---}(1+K_N)}$$

Where:

Dt	=	the dividend per share expected to be received at the end of year t
N	=	the number of year that dividend will be paid
Kt	=	the required return for year t

Note: - N could be infinity as the common stock has an infinite legal life. If firm's assets will eventually be liquidated, then N would be the number of period until its liquidation

However, if the dividend are expected to grow at a constant rate for an indefinite period of time, then the General Dividend Model would become the Constant Dividend Growth Model as :

$$P_o = \frac{D_o\,(1+G)}{Ke - G}$$

$$= \frac{D_1}{Ke - G}$$

Where:

Po	=	the intrinsic worth of stock
Do	=	the per share dividend just paid
G	=	the expected constant growth rate
Ke	=	the required return on an equity

Beside the dividend valuation model, there are other valuation models, for example, valuation model that is based on earning per share, valuation model based on cash flow per share, valuation model based on firm's investment opportunities, etc. Each of these, however, is no more than a variant of the basic dividend model, as without the prospect of future dividends, a stock is worth nothing.

1.6 The Malaysian Securities Industry

The Malaysian (Malayan) Securities Industry began in the late 19th century with the British Corporation actively involvement in the tin and rubber industries business. The Malayan Stockbrokers Association (Registered in 1938), was the first formal organization established after the establishment of the Singapore Stockbrokers' Association on June 23, 1930. However, the association had to stop operating when the second world war broke out, but it had successfully resumed its business in 1945 when the war ended. The association changed its name to Malayan Stock Exchange in 1960 and the public trading of shares started on May 9, 1960 with only four stockbrokers gathered together in the clearing house to mark prices.

The exchange marked a milestone forward when the trading post system was introduced in November 1960 and further improved by the board system in 1961 in the field of physical facilities for share trading. The trading room for Kuala Lumpur and Singapore was even more closely linked through direct telephone lines. The Stock Exchange of Malaysia was established on June 6, 1964 following the formation of Malaysia in 1963. However, it was renamed the Stock Exchange of Malaysia and Singapore following the separation of Singapore from the Federation in August, 1965.

In 1973, the announcement by the Honorary Finance Minister on the termination of the currency interchangeability arrangement between Malaysia and Singapore had led to the setting up of separate Malaysian Stock Exchange ---- the Kuala Lumpur Stock Exchange Berhad on July 2, 1973. However, on December 27, 1976 the function of the Kuala Lumpur Stock Exchange was taken over by a new company called the Kuala Lumpur Stock Exchange.

Further, from January 1, 1990 all companies incorporated in Malaysia were no longer allowed to be traded on the Singapore Stock Exchange. In contrary, all companies incorporated in Singapore were delisted from the Kuala Lumpur Stock Exchange. The split was viewed as an effort by the Government to make the Malaysian Stock Exchange totally independent from it's neighbour, the Singapore Stock Exchange.

1.7 The Development Of Stock Market

The Malaysian stock market have since gone through major development and innovations over past number of years, whereby the authorities have undertaken various steps and measures to review and put in place the necessary physical facilities, as well as the legal and institutional framework for the issuance and trading of securities. Such measures help to instill and gain public and investors' confidence in our market as well as aiming to promote an orderly market.

The major measures that have been introduced and implemented by the authorities are:

(i) To introduce the new Companies Act 1965 to provide for a more comprehensive legal framework in supervising the operations of companies.

(ii) The setting up of the Capital Issues Committee (CIC) in 1968, aimed to supervise the issuance of securities offered by public companies.

(iii) The enactment of The Securities Industry Act, 1973 to provide for an orderly conduct of the securities business.

(iv) The enforcement of the new Securities Industry Act, 1983 (To replace the 1973 legislation) to provide for more effective supervision and control of the securities industry and the activities of the stock exchange.

(v) The corporatisation of the stockbroking industry in 1987 aim to improve the financial strength of the broking firms, increase their expertise and professionalism as well as to generate greater international interest in our exchange.

(vi) The implementation of Securities Industry Regulations, 1987 to regulate and put in order the management of the application for licences relate to the stock exchange.

(vii) The setting up of the Securities Commission in 1993 to act as the authority regulating the securities industries with the enforcement of The Securities Commission Act 1993 (Act 498).

(viii) The introduction of the Security Industry (Licensing of Fund Manager and Fund Manager's Representative) Regulations, 1996, to regulate the matter relate to application for Fund Manager's Licence.

The Kuala Lumpur Stock Exchange, however, in complimenting the measures undertaken by the Government, have also initiated several major reforms to further develop and strengthen the exchange. Among the developments that have been introduced are:

(i) The implementation of the first phase of the computerised share scrips clearing system in November 1983.

(ii) The establishment of the Research Institute of Investment Analysts Malaysia

(RIIAM) in May 1985.

(iii) The introduction of the real-time share price reporting system (MASA) for brokers in 1987.

(iv) The introduction of the KLSE Composite Index in 1986 to replace the KLSE Industrial Index.

(v) The establishment of an Advanced Warning and Surveillance Unit (AWAS) in 1987 to alert on problem stockbroking firm.

(vi) The introduction of new Listing Manual in July 1987.

(vii) The establishment of Second Board on November 11, 1988 to enable potential strong growth small and medium-sized companies to be listed to raise funds.

(viii) The amendment on new listing requirement affective January 1, 1996 (Appendix III).

The KLSE have introduced a new era of modern technology in the exchange by implementing the semi-automated trading system, namely the System On Computerised Order Routing and Execution (SCORE) in 1989, to provide for market visibility on price and transactions as well as to improve liquidity in the market. With this introduction, the inefficiencies of an open outcry system have come to an end. The trading system on the

KLSE was fully automated in November 1992, which has allowed for more speedy matching of orders and up-to-date information on the real-time information system. The Securities Clearing Automated Network Services Sdn Bhd (SCAN) was also introduced to reduce the physical delivery of share between broking firms and clearing house.

In January 1990, a newly "daily netting" system, was enforced to effectively set the date of contract of all outstanding sales and purchases of the stock transacted on the same day. In addition to this, the Fixed Delivery and Settlement System (FDSS) was introduced in February 1990, with the aim to develop a more organized system of scrip movements and enhance the management of cash flow among stockbroking firms. Further, the scripless trading system, Central Depository System (CDS) was developed and implemented on March 2, 1993 with the aim to improve the efficiency of the trading and settlement system as well as to enable the exchange to handle a much larger volume of trading.

In order to improve the accessibility of investors including the foreign funds to the stock market, the exchange has, on July 22, 1992, extended its trading hours to another ninety minutes (1). Others like new financial instruments were also introduced to provide for listing of warrants of transferable subscription rights (TSRs) and the equity linked derivatives from December 2, 1989. The KLSE also amended its listing requirement

Footnote (1) : Trading hours before July 22, 1992 were from 1000 am to 1230 pm and 230pm to 400 pm. The current trading hours is from 930am to 1230 pm and 230 pm to 500 pm.

to pave way for listing of property trust in 1989, the listing of infrastructure company on September 2, 1995 and the close-end fund on October 30, 1995. The latest addition is the implementation of T + 5 clearing and settlement period on August 18, 1997 so as to strengthen the efficiency of the exchange as well as to parallel and position its standard on clearing and settlement period with other international bourse in the world as shown in table 1.1.

Table 1.1. Clearing and Settling Period of other Bourse In The World

Country	Clearing And Settleling Period (days)
U.S.A	T + 3
Japan	T + 3
France	T + 3
Hong Kong	T + 2
Taiwan	T + 2
Korea	T + 2
Malaysia	T + 7

Source: Sin Chew Business, Sin Chew Jit Poh, June 17, 1997.
Note: T = Trading Day

1.8 The Size Of The Stock Market

The Kuala Lumpur Stock Exchange has witnessed significant growth and development in recent years in various aspects, in terms of fund mobilisation, market capitalization, price indices and turnover. Our market has become one of the largest and most modern bourse in the developing world as a result of various efforts and measures undertaken by the authorities. From its modest beginnings as a group comprising only four stockbrokers in 1960 to sixty stockbrokers in operating throughout Peninsular Malaysia, Sabah, Sarawak and Labuan in 1997 (Appendix IV).

In term of market capitalization, which only amounted to RM 8 billion in 1974 has expanded to RM 99 billion at the end of 1988 and further increased to RM 566 billion in 1995, this has made the KLSE the largest market in ASEAN (Association Of South East Asian Nations) region.

The number of companies listed in the KLSE also grown rapidly where there were only 138 companies with a nominal paid-up capital of RM 708 million listed at the end of 1961, compared to 526 companies with a total value of RM 92.4 billion in 1995. It is further expected that in years to come, a target of 1000 companies will be listed on the exchange (861 company as at August 29, 1997). In terms of funds raised, the stock market comprise of the major contributions towards the total funds raised in the capital market as summarised in table 1.2.

Table 1.2 Funds Raised In The Malaysian Capital Market, 1990-1996.

Year	(In RM Million)				
	Total Funds	Public Sector	Private Sector	Shares1	Debt Securities2
1990	14,743	3,816	10,927	8,649	2,278
1991	9,390	3,157	6,233	4,392	1,841
1992	13,793	1,480	12,313	9,181	3,132
1993	6,450	1,230	5,220	3,245	1,975
1994	13,236	1,700	11,536	5,177	6,359
1995	12,445	-626	13,071	8,165	4,906
1996p	20,434	-829	21,263	11,198	10,065

Note:

1 Shares issued by KLSE listed companies
2 Securities with maturities more than 1 year
P Preliminary figures

Source - Economic Report, Ministry of Finance, Malaysia, various issues
- Annual Report, Bank Negara Malaysia (The Central Bank Of Malaysia) various issues

1.9 The KLSE Composite Index And Introduced Date

The Kuala Lumpur Stock Exchange Composite Index (KLSE CI) was introduced in 1986 (Other Indices introduction date as per Table 1.3) with the following objectives:-

(a) To effectively reflect the performances of companies listed on the KLSE;

(b) To be generally sensitive to investors' expectation;

(c) To be generally indicative of the impact of the government's policy and

(d) To be reasonably responsive to the structural changes in the different sectors of the Malaysian economy.

The composition of KLSE CI comprise a sample of stocks traded on the Kuala Lumpur Stock Exchange (Appendix V). The number of stocks included in this sample varies from time to time.

Table 1.3 Others Indices Introduced Date

Index	Date Introduced
KLSE Second Board	2nd January, 1991
EMAS	16th October, 1991
KLSE Consumers Product	1st September, 1993
KLSE Industrial	1st September, 1993
KLSE Construction	1st September, 1993
KLSE Trading/Services	1st September, 1993

Source: Kuala Lumpur Stock Exchange Library
Note: EMAS - Exchange Main Board All Shares

1.10 Criteria For Selection Stock In KLSE CI

The criteria for selection of the stock to be included in the KLSE CI are:

(a) Companies so listed on the KLSE will be considered if their major business activities contribute substantially to the Malaysian economy.

(b) No inactive companies will be considered, unless alternative companies for maintaining sector representativeness are not available. Inactive companies are companies whose shares are not traded for more than three consecutive months, due to either suspension or inactive trading.

(c) No companies whose trading volume are less than 1,000 lots (1 lot = 1,000 shares) will be considered unless alternative companies, for maintaining sector