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Foreign capital raising by Indian firms: An examination of domestic stock price response

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ABSTRACT

We examine the domestic stock price response to foreign capital issuance by Indian firms. Firms have extensively used foreign equity and convertible foreign debt sources since 1994. The role of foreign investment bankers, size of the issue, firm's growth opportunities, and other factors are examined in the cross-sectional analysis of domestic stock price response. We find that firms experience positive stock price response to both equity and debt issues abroad, with greater response to issuance of American Depositary Receipts (ADRs), and financing high corporate growth.

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1. Introduction

We examine the domestic stock price response when Indian public firms issued either equity or debt securities in international markets following the economic liberalization of India in the early 1990s. Previous studies in the literature have examined firm level response to particular types of issue across a number of countries with a focus on the domestic stock price response; American Depositary Receipts (ADRs) issues (Miller, 1999) and public debt issues (Miller & Puthenpurackal, 2002). These and similar studies focus on the cross-country determinants of stock price response and relate variations therein to the prevailing legal structures and protection from various financial claimants across the sample countries.

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We focus on three major issues in this paper, which differ from earlier cross-country capital issuance studies. First, we examine capital issues made by firms from only one country – India. A country-specific analysis allows for a focused examination of the determinants of the market response and enables us to identify firm-specific factors that influence the creation of value for the issuer.

Second, our time period of analysis spans foreign capital issuances over 1993–2009: a period during which the regulatory and legal structures in India underwent modifications. Specifically, equity issues in the earlier period were subject to extensive government scrutiny and monitoring. In the latter period, a greater level of the monitoring activity was undertaken by external rating agencies and other private interests. We measure the differential impact of the monitoring/certification across these time periods and thereby attempt to isolate the value impact of regulatory changes.

Third, we examine the response of "group" firms. Earlier Indian-based studies have shown that large group companies in India are positioned to create value in many corporate activities, because of their superior managerial ability, processes, and ability to exploit the regulatory structure (Khanna & Palepu, 2000). We examine whether such large group companies are able to create additional value in foreign capital-raising efforts by developing expertise in foreign markets similar to their purported abilities to exploit market, and structural inefficiencies domestically in India.

At a broad level of analysis, we investigate issues of capital market segmentation and information asymmetries. At the beginning of the sample period, the Indian capital market is segmented from the world market. As the liberalization process unfolds, the barriers are removed and some firms are better equipped, or better able to exploit the removal of barriers and/or to mitigate the effects of informational asymmetry.

We find significant positive domestic stock price response to the announcement of Indian firms issuing equity and debt securities abroad. We relate the abnormal returns to firm/issue specific variables including the following: issue size (positive), foreignness of the investment banker (IB) (+), high firm growth (+), relatively high foreign offer price (+), first time issuers (+), and ADR issuers (+). We find that the value consequence of external private monitoring is similar to that of monitoring by Indian regulators. Thus, monitoring by external entities is perceived to be as effective as that of the regulator. We find weak evidence that large group companies issuing foreign securities create additional value.

This paper is organized as follows. We provide a discussion of some of the literature regarding issuance of foreign securities by firms in the following section. In Section 3, we provide a brief summary of the economic liberalizations undertaken in India subsequent to its balance of payments crisis in 1990, and present hypotheses that are examined in this paper. We describe the data in Section 4, and provide a discussion of the role of foreign capital and the role of the IB in the capital raising process. We discuss the authorization process, the measurement of the market response, and the cross-sectional regression analyses in Section 5, and present concluding remarks in Section 6.

2. Literature on foreign capital issuance

There is an extensive body of literature that examines the potential costs and benefits of issuing capital in foreign markets. The cross-listing valuation benefits to going abroad arise primarily from two sources: (1) benefits arising from issuing securities in a foreign market (Karolyi, 2012), and (2) benefits arising from a reduction in informational asymmetries (Bris, Cantale, & Nishiotis, 2007).

Managers indicate in surveys that a variety of benefits accrue to listing securities in foreign markets. These benefits include access to larger and deeper market for capital, reduced market segmentation, diversification of ownership base, and greater trading liquidity that benefits shareholders. With regard to the concerns of information asymmetry, global security issuance may attract more analyst coverage and market monitoring and thereby reduce asymmetric information problems (Hasan, Kobeissi, & Wang, 2011).

The benefits arising from reduced informational asymmetries fall broadly into two broad categories: (2a) the benefits due to bonding hypothesis that arises from the commitment made by the firm to increase its disclosure and legal obligations to its investor base both domestic and foreign, and (2b) the signaling hypothesis suggesting that the firm, by the act of listing abroad, conveys its higher quality to market participants. Firms subject themselves to greater monitoring and scrutiny by listing abroad and thereby create value (Fernandes & Giannetti, 2014; Stulz, 1999).

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