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Effects of regulator's announcements, information asymmetry and ownership changes on private equity placements: Evidence from China☆

M.M. Fonseka [a,c,*], Sisira R.N. Colombage [b], Gao-Liang Tian [c]

[a] *Department of Accounting & Finance, School of Business, Xi'an International Studies University, PO Box 84, Xi'an 710128, Shaanxi, PR China*
[b] *Department of Accounting & Finance, School of Business and Economics, Monash University, Northways Road Churchill, Victoria 3842 Australia*
[c] *Department of Accounting & Finance, School of Management, Xi'an Jiaotong University, No. 28, Xianning West Road, Xi'an 710049, Shaanxi, PR China*

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ABSTRACT

In response to the China Securities Regulatory Commission's regulation of private equity placements (PEP) in 2006, this study investigates the impact of the announcements of PEP applications, withdrawals, rejections, approvals, and completions on the returns of the firms that issue private equity (PE) and the factors that influence market reactions to these announcements. The results show that issuing firms experience stock price responses only to the announcements of PE applications, approvals, and completions. The

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* Corresponding author. Tel.: +86 15229260277.
E-mail addresses: mohanf1986@gmail.com, mohanfonseka@yahoo.co.uk (M.M. Fonseka), sisira.colombage@monash.edu (S.R.N. Colombage), tian-gl@mail.xjtu.edu.cn (G.-L. Tian).

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announcement effect is positively related to the market discount, proceeds from private placements, and private institutional buying and ownership changes; and negatively related to government or government institutional buying and changes in the ownership of management buyers.

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1. Introduction

In recent years, private equity investors have increasingly turned to China in search of higher returns. As a result, private equity placements (PEPs) have become an important source of equity refinancing for Chinese listed firms, accounting for 85% of the number of firms and 81% of the value of seasoned equity financing during the period from 2006 to 2009 (Yu and Xu, 2010). In recognition of the growing significance of PEPs as a source of financing, the China Securities Regulation Commission (CSRC) moved in 2006 to place PEPs under its regulatory ambit by requiring firms to meet its approval criteria before making PEPs.

The Chinese regulatory requirements in relation to PEPs provide a unique setting to examine the effects of various regulatory driven stages of the placement process on the stock returns of the firms making the PEPs. We study the announcement effect of PEPs on issuing firms during the PEPs process and the factors that might explain the cross-sectional variation of the announcement effects. We first estimate the announcement effect on the returns of issuing firms when making applications, withdrawals or rejections, gaining approvals, and completing PEPs. We then conduct cross-sectional tests to examine the relationship between abnormal returns and the information and ownership effects.

The issuance of PE has important implications for various agents including investors, industry competitors, and issuing firms. It is important for investors, when making portfolio allocation decisions, to know how PEPs affect the stock market performance of issuing firms. Similarly, issuing firms need to understand how their PE issuance affects the competitive environment and how they can use this to form strategies to obtain an advantage over competitors. Private equity placements in China are highly regulated compared to other markets and, therefore, this study's findings enhance the existing literature. Further, this study enhances knowledge about investors, issuing firms, competitors and security market regulators in the Chinese context.

We find that issuing firms experience an increase in their stock price in response to the announcement of an application, approval, and completion of PEPs; and no effect around the announcement of the withdrawal or rejection of applications. The announcement effect is positively related to market discount, proceeds from private placements and private institutional buying, and negatively related to government or government institutional buying. Further, the announcement effect is positively related to changes in ownership of private institutional investors and negatively related to changes in ownership of management buyers.

Our research provides an important contribution to the literature in the followings ways. First, due to the transitional nature of the Chinese economy, the Chinese stock market functions differently to those of the major market economies due to it being heavily regulated (Bo et al., 2011). The issuance of securities in China is regulated by the CSRC, the regulatory requirements of which are primarily determined by quantitative and qualitative criteria, to discriminate between firms seeking access to equity finance (Fonseka et al., 2012). Now that the CSRC regulates PEPs, China provides an example of a highly regulated financial system. A shortcoming of previous studies is that they examined the announcement effect in isolation of the regulatory process for PEPs. This study contributes to the existing literature on seasoned equity offerings (SEO) in a highly regulated market by expanding our understanding of the motivation and effect of the regulatory process on the stock price performance of firms issuing PEPs.

Second, we investigate whether the announcement of PEP applications, withdrawals, rejections, approvals, and completions affect the PE issuing firms' returns. We also examine the factors that influence the announcement effect in PEP events by examining the differences in the stock price

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