Long-Run Underperformance on Seasoned Equity Offerings: An Evidence from Indonesia

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ABSTRACT

The research aimed to analyze the underperformance phenomenon following Seasoned Equity Offering (SEO) in Indonesian context. Samples were all firms listed on the Indonesia Stock Exchange with the right issue in the observed periods, were chosen by purposive sampling with several criteria. In total, there were 109 issuing firms from 2009-2014 that were analyzed using performance benchmarking approaches. The approaches consisted of market-based, size-based, growth-based, and industry-based benchmarks. The market-based was constructed using a market return. Then, the size and the growth benchmarks were constructed on the basis of closest market capitalization and closest price-to-book value respectively. Then, the industry benchmark was based on a closest combined of market capitalization and Price to Book Value (PBV) of matched firms within the first-second digit of Standard Industry Classification (SIC). The test was conducted using standard t and Wilcoxon tests by examining the benchmark-based abnormal returns over various spans ranging from 3 to 36 months following the right offerings. Like several findings in developed countries, the results also confirm the underperformance phenomenon following right offerings in Indonesia. The negative abnormal returns are found for all benchmark performances, but they are only significant for the market benchmark and partially significant for the size and the growth benchmarks. Behavioral explanations need to be modeled to reveal the intuitions behind the results..

Keywords: underperformance phenomenon, issuing firms , Seasoned Equity Offerings (SEO)

INTRODUCTION

As one of the most essential sources for raising additional capital, Seasoned equity offerings (SEO) becomes one of the corporate events attracting attention in the asset pricing arena. The most dominant issue that has been studied following SEO is the long-run underperformance of firms conducting SEO. Many empirical studies find that issuing firms have relatively low returns in the three to five years after SEO (Loughran & Ritter, 1995; Bessler, Drobetz, Seim, & Zimmermann, 2016; Devos, Devos, Ong, & Spieler, 2017; Dutta, 2017; Eom, 2014; Kothari, Mizik, & Roychowdhury, 2016; Lizinska, 2018; Mansali & Daadaa, 2018).

Like other corporate events, SEO represents a signal regarding the potential performance of a firm in the future and the ability of management in accelerating the firm performance. Thus, irrespective of the underlying motives, rational investors should immediately adjust their valuations to reflect this new set of information, and the stock prices should immediately shift to a new equilibrium level following the adjustment. Therefore, under the paradigm of market efficiency, the stock prices of issuing firms, on average, should adjust gradually with all necessary revaluations being completed and the post-SEO stock performance of the firms should also perform on average (no better or worse than the rest of the market) (Andrikopoulos, 2009).

This long-run underperformance has been advanced by many researchers using various explanations such as investor over-optimism (Loughran & Ritter, 1995; Yi, El-Badawi, & Lin,

2008), pre-earning management (Cohen & Zarowin, 2010; Kothari *et al*., 2016; Shu & Chiang, 2014), market timing (Brisker, Autore, Colak, & Peterson, 2014; Huang, Uchida, & Zha, 2016; Kaya, 2014; Qian, 2014), and the intended use of proceeds and the quality of underwriter (Silva & Bilinski, 2015).

Loughran and Ritter (1995) suggested that this underperformance occurred because investors corrected their over expectations towards information contained in SEO. Many researchers further observe this premise, and the findings are mixed. Lizinska (2018) used six benchmarks to analyze the post-performance of Indian SEO firms and found consistent underperformance after SEO. However, her findings were sensitive over the benchmarks and the reference portfolios. Although it confirmed a negative association between post-issue performance and pre-issue investor optimism, Yi *et al*. (2008) found a little evidence about the effect of the over-optimism to firms' financing choices. However, using a similar approach, Brous, Datar, and Kini (2001) suggested different findings. Using different benchmarks to estimate the performance of issuing firms, they failed to confirm that the underperformance following SEO was caused by over-optimism. Da Cunha and Seetharam (2018) also confirmed the same results as Brous *et al*. (2001). Meanwhile, using the analysts as the unit of analysis, Devos *et al*. (2017) only stated that the over-optimism appeared after IPO instead of SEO.

Other researchers find that this underperformance is strongly related to the manager's attempt to inflate reported earnings at the time of the SEO. Both Cohen and Zarowin (2010) and Kothari *et al*. (2016) proved the consistent results about the issue that in turn led to the overvaluation at the time of SEO. Shu and Chiang (2014) had a different result between small and larger firms. They discovered that for small firms, the timing effect was negatively correlated with their long-term wealth. Meanwhile, for large firms, earnings management played the role.

Har and Visvanathan (2018) proposed the different premises and assumed that the underperformance is caused by the overvalued premium by issuing firms. They argued that the firms took advantage of their overvalued stocks by timing the market and issue new shares to acquire additional capital. This fact led the market to correct the price in the periods after SEO. Moreover, Brisker *et al*. (2014) concluded that this market timing could relate to the managers' incentive for their wealth maximization. According to their results, the managers who received high equity-based reward had greater incentive to avoid ownership dilution by timing their SEO to periods when investors overvalued the stocks.

Meanwhile, Harris (2003) found that the underperformance only occurred to the firms issuing new shares for investment and acquisition, and not for those issuing them for debt settlement. Furthermore, Huang, Ho, Lin, and Yen (2014) stated that the underperformance only occurred to young issuing firms instead of mature issuing firms and linked the results to their higher risk of future profitability of young firms. Silva and Bilinski (2015) enriched the explanation behind the underperformance by investigating the intended use of the SEO proceeds and the quality of underwriter. Based on the results of their study, the issuing firms citing investment needs showed no abnormal performance after SEO and had higher investment rates post-issue compared to the period before SEO. Meanwhile, the issuers stating general corporate purposes and recapitalization motives tended to underperform, had similar investment rates pre- and post-issue, and their leverage tended to increase after SEO. Further, the results also revealed that low-quality of SEO underwriters exhibit post-negative abnormal performance.

In addition to the explanations, another explanation arises from a methodological perspective. For example, Fama (1998) suspected that a misspecified or bad model in estimating the returns might cause the emergence of this phenomenon. However, the argument seemed not successfully convincing because some researchers afterward such as Jegadeesh (2000) and Loughran and Ritter (2000), found a consistent and robust underperformance of issuing firms post-SEO, even after they accounted for some potential methodological biases. Jegadeesh (2000) provided evidence on the inappropriateness of factor-model benchmarks and the robustness of the long-run underperformance of issuing firms. Similarly, using the three-factor model from Fama and French (1996) in a set of various simulations, Loughran and Ritter (2000) concluded that the underperformance of issuing firms after SEO was a reliable result in high or low volume equity-issuance periods.

Additionally, Allen and Soucik (2008) argued that the existence of this underperformance phenomenon depended on the span to which "the long run" was defined. While many researchers confirmed the long-run underperformance over three to five years after SEO, they claimed that if the span was defined as twelve years instead of five years, issuing firms tended to outperform non-issuing firms during the sixth and seventh years. Other researchers such as Eckbo, Masulis, and Norli (2000), Huang *et al*. (2014), and Du, Chen, and Zhang (2016) also documented the absence of the underperformance after accounting for several issues. Eckbo *et al*. (2000) found that the issuer's underperformance reflected lower systematic risk exposure for issuing firms relative to the matches. This exposure decreased the issuer's exposure to unexpected inflation and default risks. Thus, it decreased their stocks' unexpected returns relative to the matched firms. In addition to the risk exposure, Huang *et al*. (2014) also documented that the underperformance only occurred for young issuers but not for mature issuers. They argued that the greater uncertainty of the young firms' future profitability drove the results. Meanwhile, Du *et al*. (2016) did not find any evidence for post-SEO underperformance compared to the matched firms and confirmed the positive association of the performance with pre-

return on equity.

Apart from the mixed results for such underperformance around SEO and the various explanations following the phenomenon, research regarding SEO issues in Indonesia is still rarely addressed. The research regarding the right issue as one form of SEOs has been conducted by Susanti and Ardiana (2014), Kamalsah and Panjaitan (2015), and Bahri (2018). However, instead of focusing on the long-run underperformance, they generally address the short-term market reactions to the right issue announcement using the common event study methodology. Additionally, the short pre and post-performance comparison of issuing firms are considerably addressed.

Moreover, the performance issues following right offerings in literature are more about the long-run performance of the issuing firms which needs the longer horizons of the observed periods (Dutta, 2017; Lizinska, 2018; Mansali & Daadaa, 2018; Wang, Gao, & Wang, 2015; Young & Wu, 2017). Another Indonesian research regarding SEO is conducted by Rafik and Arafah (2019). Nevertheless, their study focuses on the short run spillover effect of SEO on the non-issuing firms within the industries.

This research undertakes the role in enriching the Indonesian studies regarding SEO by examining whether the long-run underperformance of issuing firms exist in Indonesia or not. Regarding the offerings, the researchers only focus on right issuance and not to another kind of SEOs that may exist during the observed periods.

Although various results and explanations appear in literature, many researchers confirm that this long-run underperformance phenomenon is prevalent in the stock markets either in developing countries such as India (Lizinska, 2018), Chinese (Du et al., 2016), Tunisia (Mansali & Daadaa, 2018) or in developed countries such as United States of America (Eom, 2014), Australia (Dutta, 2017), and Germany (Bessler et al., 2016). Thus, to prove the existence of this underperformance phenomenon in Indonesia, the first hypothesis is formulated as follows:

H1 : there is the underperformance of issuing firms following right offerings.

To robust this analysis, the researchers also adopt benchmarking methods which are used by some scholars such as Jegadeesh (2000) and Harris (2003). The benchmarks are chosen based on the prevalent evidence in the literature suggesting that the variation of return corresponds to the specific variables such as the size and the growth premium (Ltaifa, 2018; Mohrschladt, 2018; Raghuram, 2017; Rashid, Sadaqat, Jebran, & Memon, 2018), and the industry characteristics (Thomas & Zhang, 2008; Ben-David, Birru, & Rossi, 2019).

The size benchmark is proxied by the market capitalization by several researchers such as Harris (2003), Assefa, Esqueda, and Galariotis (2014), Mohrschladt (2018), Shaharuddin, Lau, and Ahmad (2018), and Roszkowska and Langer (2019). Harris (2003) found negative returns over five years following SEO, and the underperformance consistently occurred for the various size-groups (small, medium, and big size). Based on the literature, the researchers formulate the second hypothesis as follows:

H2 : there is the underperformance of issuing firms following right offerings using the size-benchmark.

In the literature, the growth benchmark is proxied by Price to Book Value (PBV). For example, Banerjee, De, and Bandyopadhyay (2018), Harshita, Singh, and Yadav (2018), and Woltering, Weis, Schindler, and Sebastian (2018) used PBV as the growth proxy for benchmarking the firm performance. This proxy is also widely acknowledged in a three-factor model of Fama and French (1996) as a common factor of risk for the firms. The literature presumes that the firms with a lower growth opportunity (lower PBV) tend to have a greater return than those with higher growth (higher PBV). Therefore, the researchers also hypothesize the third hypothesis as follows:

H3 : there is the underperformance of issuing firms following right offering using the growth-benchmark.

Thomas and Zhang (2008) found a positive return correlation for firms in the same industries. Moreover, Ben-David et al. (2019) argued that industry familiarity could be an advantage for investors. Therefore, the information spillovers have been studied by many researchers to shed light on the issue regarding the performance. For example, it is found that the earning announcement tends to have spillovers effect on the firms in the same industry due to the positive correlation of the business (Foster, 1981; Prokopczuk, 2010; Cazier, Desir, Pleiffer, & Albert, 2018). Thus, the researchers also assume that the right offerings may deliver a spillover effect to the industry, and formulate the fourth hypothesis related to industry-benchmark.

H4 : there is the underperformance of issuing firms following right offering using the industry-benchmark.

The main objective of this study is to provide evidence from the Indonesian context in regard to the post-SEO performance of firms conducting the right issues. Using the benchmarking methods, it is expected that this research will be able to enrich the insight into studies regarding the long-run underperformance of right issuing firms in emerging markets, especially in the Indonesian market.

METHODS

The population in this research is all firms listed on the Indonesia Stock Exchange with the right issue in the observed periods. The sample is chosen by purposive sampling with several criteria. First, the firms issue right during the period of 2009-2014. Second, the firms must have complete data during the observed period. Third, the issuing firms do not issue the subsequent right for the latest three years after the first right. The last condition is applied because the researchers observe the performance of issuing firms three years after the offering.

The data needed are generated from the Kustodian Sentra Efek Indonesia (KSEI - the Indonesian Central Securities Depository) and Bureau van Dijk. The data comprise of the monthly stock prices, the monthly market return, the monthly market capitalization, the monthly PBV, and the industry category from Standard Industry Classification (SIC). The data are generated both for the issuing and non-issuing firms.

To generate the benchmark of size and growth for each issuing firm, the researchers sort the market capitalization and the PBV of non-issuing firms from the smallest to the largest and pick a benchmark firm for each issuing firm on the basis of the closest market capitalization and PBV. Thus, if firm A issues right on January 11th, the researchers will choose the nearest market capitalization (PBV) from the market, consisting of all listed firms in Indonesia, on the same date for the firm A to get a size (growth) benchmark. In case the closest benchmark firm also issues a corporate action announcement on the date, the researchers will choose the second closest market capitalization and PBV of firms that is free from any corporate action announcements. Meanwhile, for the market and industry-benchmarks, the researchers pick up the market return in the corresponding date for the market-benchmark and the return of the closest combined of market capitalization and PBV of matched firms within the first-second digit of SIC for the industry-benchmark.

Table 1 Sampling Process

Description	Sampling process
Firms issuing right offering in the period 2009-2014	142
Issuing firms which also conducted right issues in the latest three years before the current right	27
Firms with incomplete data during the observations	6
Total sample	109

The performance measurement used is a simple abnormal return of issuing firms. The abnormal return is adjusted to the return for non-issuing firms following the benchmarks. So, for the market-based performance, the researchers subtract the return of each issuing firm with the market return in month ts (a month after right offering until 36 months afterward). For the size and the growth-benchmark, the researchers subtract the return of issuing firms with the return of picked size and growth benchmark of non-issuing firms. For the industry-benchmark, the researchers conduct the same mechanism for computing the abnormal return. However, to determine the industry-benchmark of the non-issuing firm for each issuing firm, the researchers select the benchmark based on the closest size in the industry.

Each benchmark-adjusted return for issuing firms is averaged over three years after SEO and tested using the Standard t-test for the mean, and the Wilcoxon test for the median. Table 1 presents the sampling process of this study. In total, 142 firms issue right in 2009-2014, but only 109 firms were selected as the final sample because of overlapping right issuance (27 firms) and data incompleteness (6 firms).

RESULTS AND DISCUSSIONS

Table 2 provides the descriptive statistics of market capitalization and the price to book value of the issuing and non-issuing firms during the observed periods. To deal with the normality issue, the researchers conduct the Jarque-Bera test. From Table 2, it can be seen that Jarque-Bera is very high. It means that the error is not from the normal distribution. However, the analysis can still be conducted because the normality is not the main issue in this study context.

To obtain an early pattern of the issuing firms' performance, the researchers compare the average raw returns of issuing firms and those are the benchmarks (Figure 1). It can be seen from Figure 1 that the raw returns of issuing firms start to be negative from the first three months after right issuance. The negative returns are gradually less severe in the next six, twelve, eighteen, twenty-four, and thirty-six months after right offerings. Meanwhile, all the benchmarks exhibit positive returns and a gradual increase in the returns over the months. The worse returns of issuing firms seem to occur in the first three months which can indicate that the short-term reaction may be the case.

Using short-time observations, Rafik and Arafah (2019) identified the reversal patterns of issuing firms' returns in Indonesia during 2009-2016. They found significant positive returns in the day 0 to day 4 and the positive returns started to be negative from day 7 to day 10 (day 10 was the maximum length of their window periods). It seems to indicate that the market can positively exploit the right issue information in the short term. The market seems to initially assume that the right issue carries a positive signal but fails to sustain the belief on an ongoing basis. The positive

Table 2 The Descriptive Statistics of MC and PBV
of Issuing and Non-Issuing Firms

	Market Capitalization (MC)*		Price to Book Value (PBV)	
	Issuing Firms	Non-Issuing Firms	Issuing Firm	Non-Issuing Firms
Mean	6.359.881	5.992.283	1,94	1,98
Median	1.435.680	1.301.513	1,1	1,1
Max	121.776.800	115.945.061	14	13
Min	13,5	11,84	-8	-2,7
Skewness	4,94	5,01	1,48	2,18
Kurtosis	27,94	29,33	5,64	5,94
Z Skewness	21,05	21,36	6,29	9,28
Z Kurtosis	59,55	62,50	12,03	12,65
Jarque Bera	469,28	485,12	39,86	86,56
N	109	109	109	109

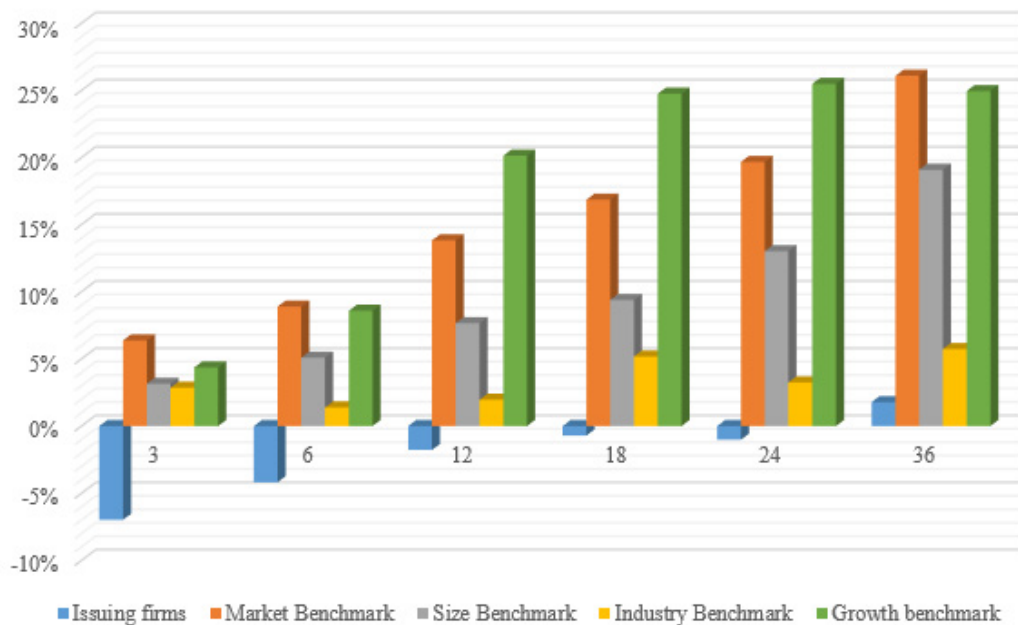* Market capitalizations are in millions IDR (Indonesian Rupiah)

Figure 1 The Average Raw Returns of Issuing Firms Relative to Benchmarks

returns in 4 days after the rights issue like Rafik and Arafah (2019) identified can also merely denote the ongoing distribution phase of the rights from the old shareholders to the market.

If the market initially believed that the right issue is prospective, the old shareholders will use their rights to buy new shares. Meanwhile, non-old shareholder investors will try to accumulate the shares from the market with premiums. As a result, stock prices may increase in the short term. But, as soon as this distribution phase is completed, the market will take place with relevant and rational considerations, and the prices may reverse.

Table 3 provides the first test results for the hypotheses by which the Average Cumulative Abnormal Return (ACAR) of issuing firms for all-benchmark measurements is examined using t-test. The results show that ACAR is negative and significant in all periods for market-benchmark performance. The negative return and significance are more prevalent in the 36 months. It means that the negative return exists from the three months after the right offering, and it gets higher over months. The similar patterns can also be seen for the size-benchmark return. However, the negative return is not significant for 18 months. Although it is consistently negative for all benchmarks, the ACAR is not significant using the growth and the industry benchmarks.

The researchers also conduct the test for

the median of ACAR and the results are provided in Table 4. Like the test results in Table 3, the significant negative returns are found using the market benchmark, but they are partially significant using the size benchmark. In the size-benchmark, there are two periods with insignificant ACAR, periods 18 and 24 months. Moreover, the significant negative returns also appear in the growth-benchmark and over three months in the industry-benchmark (Table 4). Thus, it can be concluded that underperformance also exists in Indonesia. However, the significance of the downtrend returns is sensitive to the benchmark of return used to estimate the performance.

The results regarding the underperformance using the market and size-benchmarks are consistent with the previous studies conducted by Harris (2003) and Lizinska (2018). Although it is not consistently significant, the abnormal returns for all benchmarks are consistently negative following the right offerings. Thus, if it is believed that the market will always reflect all available information and discounts all risks as hypothesized in the efficient market hypothesis, the significant negative return using the market-benchmark fairly denotes the underperformance phenomenon on right offerings in Indonesia.

Eckbo *et al.* (2000) stated that the use of different benchmarks as the expected return indeed affected the adjusted returns on long-term observations. They found that there was no underperformance when they used a factor model as the benchmark. Similar evidence is also seen by Fu and Huang (2015). Using the Securities Data Company (SDC) US Database, they found no underperformance in the middle of their observation (2003-2012). They argued that the disappearance of the underperformance correlated with the market environmental factors. Meanwhile, Eom (2014) suggested that after including the systematic risk factors, the underperformance was no longer exist.

This research has several weaknesses. For computing the performance, the model does not directly incorporate the benchmarks into the formal model like factors-models. To some extent, it creates a problem in interpreting the results solidly. This research also does not control the possible variation of returns due to other corporate actions except for the subsequent right issues during the observed periods. Moreover, many researchers have further examined about the intuitions behind the underperformance (Loughran & Ritter, 1995; Devos *et al.*, 2017; Huang *et al.*, 2014; Shu & Chiang, 2014; Kothari *et al.*, 2016). Many researchers believe that the underperformance phenomenon strongly correlates with earning management before SEO (Cohen & Zarowin, 2010; Kothari *et al.*, 2016; Shu & Chiang, 2014). The researchers do not further robust out the results following this mechanism and let the issues open for the next studies. As a preliminary study regarding the long-run underperformance following right issuance in Indonesia, to the researchers' knowledge, these results provide the initial evidence that can be further explored by researchers in the future.

These findings contribute to asset pricing or post-performance issues for right-issuing firms in emerging markets, especially in Indonesia. Although this study cannot reveal the intuitions behind the underperformance, the preliminary findings at least give managers an initial insight regarding how the SEO should be used in accordance with the target of optimum capital structure. For instance, if the proceeds from SEO is for a higher risk project, managers need to consider the project value carefully using various scenarios so that the negative signal from SEO can be eliminated. A well-made strategic plan for the use of the proceeds should be disclosed in the prospectus as detailed as possible. Moreover, industry timing also matters. As the finding does not find significant abnormal returns in the industry-based benchmark, managers need to avoid the SEO issuance when the market of the industry is unfavourable. However, the robustness of such implications must be further elaborated. This research also does not investigate the intuitions behind the results. Furthermore, the researchers cannot disentangle the conditions or motivations which the long-run underperformance of SEO will still exist or not.

Table 3 The Results of the T-Test for Average Cumulative Abnormal Return (ACAR)

Periods	Market-Benchmark		Size-benchmark		Growth-benchmark		Industry-benchmark	
	Mean	t	Mean	t	Mean	t	Mean	t
3 Months	-0,134	-2,47**	-0,079	-3,22***	-0,094	-1,163	-0,076	-0,979
6 Months	-0,131	-1,63*	-0,060	-1,94**	-0,103	-0,797	-0,030	-0,256
12 Months	-0,156	-1,49*	-0,056	-1,51*	-0,193	-0,758	-0,010	-0,061
18 Months	-0,176	-1,37*	-0,036	-0,8148	-0,234	-0,600	-0,022	-0,108
24 Months	-0,207	-1,49*	-0,091	-1,72**	-0,249	-0,593	-0,022	-0,095
36 Months	-0,237	-1,751**	-0,174	-2,71***	-0,220	-0,520	-0,021	-0,067

***, **, and * denote significance at the 1%, 5%, and 1% respectively

Table 4 The Results of the Wilcoxon Test for Average Cumulative Abnormal Return ACAR)

Periods	Market-benchmark		Size-benchmark		Growth-benchmark		Industry-benchmark	
	Median	z	Median	z	Median	z	Median	z
3 Months	-0,126	-4,28***	-0,089	-2,32**	-0,071	-2,14**	-0,084	-2,43**
6 Months	-0,139	-3,31**	-0,071	-1,568	-0,089	-1,945*	-0,044	-0,866
12 Months	-0,189	-3,415**	-0,095	-1,926*	-0,197	-2,042**	-0,106	-0,588
18 Months	-0,191	-2,79**	-0,089	-0,887	-0,205	-2,209**	-0,017	-0,271
24 Months	-0169	-3,04***	-0,143	-1,451	-0,227	-2,118**	-0,049	0,050
36 Months	-0,133	-4,40***	-0,126	-1,95*	-0,220	-1,589	-0,065	-0,062

***, **, and * denote significance at the 1%, 5%, and 1% respectively

CONCLUSIONS

Like many findings in the developed countries, these results also confirm the underperformance phenomenon after the right offerings. Although the consistent negative returns are found over months (3 to 36 months) following right issues, the significance only appears when the benchmark of the abnormal returns is computed using the market-benchmark and partially appears when the benchmarks are the size and the growth-benchmarks. Meanwhile, the significance of abnormal return disappears when the benchmark is the industry-based benchmark.

Several issues can be addressed by the next research to complement these findings. The future researchers can directly incorporate the relevant benchmarks into the formal model like the three-factor model from Fama and French (1996) or four-factor model from Carhart to adjust the abnormal returns of issuing firms. So, the sensitive results over the benchmarks and momentum effect can be anticipated. Furthermore, the future researchers can involve the longer time horizons with the larger sample so the separation of samples can be made to identify whether the various motivations of Indonesian SEO also determine the performance or not. In addition, they can also address the behavioral explanations of why the underperformance phenomenon exists in Indonesia.

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