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EXCHANGE RATE EFFECTS ON A SMALL OPEN ECONOMY: EVIDENCE FROM TAIWANESE FIRMS

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ABSTRACT

Previous empirical research discovered only mild, if any, sensitivity of firm value to exchange rate fluctuation. Chen et al. (2004) provided some insights by focusing on a small and open economy and found evidence that New Zealand that exchange rate movement affects firm value. This study reexamines firm value sensitivity to exchange rate fluctuation by focusing on individual firms as well as on three industry Taiwan sectors, high-tech, service, and manufacturing industries. By using the two-factor model with residual regression, we find consistent results that volatility of exchange rates affects the value of Taiwanese firms. The results hold regardless of the exchange rate exposure to US dollar, Japanese Yen, or Euro. In addition, the positive association between exchange rate exposure and firm value is significant and consistent for all firm samples and three industry-specific samples.

JEL: F31

KEYWORDS: Foreign exchange exposure, Residual regression, Exchange rate fluctuations, Firm value

INTRODUCTION

With the ever increasing tempo of economic globalization, more firms face international competition. It is widely accepted that fluctuations in exchange rates affect the competitive position of firms in the global market, and eventually impacts cash flows and firm value. Moreover, even for a domestic firm that is not actively involved in international trade, variations in exchange rates may indirectly affect firm value. This is especially true if the firm relies on imports to obtain raw materials, if its suppliers are subject to exchange rate exposure, or if the firm's competitors are from overseas.

Presumably, only unanticipated fluctuations in exchange rates affect firm value. According to the efficient market hypothesis, the expected change in exchange rate should be priced into a firm's stock price. Therefore the relation between unexpected exchange rate change and share price should be observed. However, previous studies failed to document a strong relationship between unexpected movement of foreign exchange rates and changes in share price. Many studies only discovered weak or insignificant associations between firm value and exchange rate exposure (Jorin, 1990; Gao, 2000; Griffin and Stulz, 2001; Di Iorio and Faff, 2002). Even if a significant sensitivity was found, the mean sensitivity values were far below what is predicted by theories (Booth and Rotenberg, 1990; Choi and Prasad, 1995; Frennberg, 1994).

A few empirical studies found significant exchange rate risk sensitivity under certain conditions. Bartov and Bodnar (1994) found that abnormal returns are related to lagged changes of exchange rates, which supports market inefficiency. The studies by Chow et al. (1997) and Bodnar and Wong (2000), show the association between firm value and exchange rate changes becomes significant when the time horizon is increased. According to Jorion (1990) and Shin and Soenen (1999), the magnitude of exchange rate exposure varies by firm size.

These mixed results are typically attributed to three causes. First, different models were employed and different firm sample sizes were selected. Usually different methodologies lead to divergent results.

THE EFFECTS OF EXCHANGE RATE VOLATILITY ON SOUTH AFRICA'S TRADE WITH THE EUROPEAN UNION

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ABSTRACT

In this paper we analyze the effects of the real exchange rate volatility on South Africa's trade flows with the European Union over the period 1980 to 2009. Our study uses quarterly trade flows on South Africa's exports and imports and utilizes the bounds testing approach to cointegration, and error-correction model. Our results reveal that imports depend positively on the levels of domestic economic activity and foreign exchange reserves but negatively on relative prices and exchange rate volatility. In addition, exports depend positively on the levels of foreign economic activity but negatively on relative prices and exchange rate volatility. Furthermore, the exchange volatility exerts mixed effects in the short-run and in the long-run.

JEL: F14, F31

KEYWORDS: South Africa, imports, exports, exchange rate volatility, panel cointegration

INTRODUCTION

Despite the sizeable number of studies conducted, no real consensus about the impact of exchange rate volatility on exports has emerged. While a large number of studies find that exchange rate volatility tends to reduce the level of trade, others find either weak or insignificant or positive relationships. For example, Onafowara and Owoye (2008), Byrne, Darby, and MacDonald (2008), Choudhry (2005), Bahmanee-Oskooee (2002), Arize, *et al.* (2000), Arize (1995), Chowdhury (1993), Pozo (1992), and Bahmani-Oskooee and Ltaifa (1992), find evidence for negative effects. According to these scholars, exchange rate volatility may affect exports directly through uncertainty and adjustment costs for risk-averse exporting investors. Further, it may have an indirect effect through its impact on the structure of output, investment and government policy. On the other hand, Doyle (2001), Chou (2000), McKenzie and Brooks (1997), Qian and Varangis (1994), Kroner and Lastrapes (1993), and Asseery and Peel (1991) find evidence for a positive effect for volatility on export volumes of some developed countries because exchange rate volatility makes exporting more attractive to risk-tolerant exporting firms. However, other scholars such as Aristotelous (2001), Bahmani-Oskooee and Payestch (1993), Bahmani-Oskooee (1991), and Hooper and Kohlhagen (1978) have reported no significant relationship between exchange rate volatility and exports.

Reasons for contradictory results by different studies may be due to a variety of factors, among them: different methods used to measure exchange rate volatility; the use of different price deflators; the differential use of sample data, for example, the use of aggregate export data versus sectoral export data; different time-frame periods; ignoring import dependency on intermediate and capital goods of the receiving country, as is the case with many developing countries; and the absence of complex econometric methods for studying these variations. As a result scholars stopped investigating the exchange rate volatility-export nexus by the late 1990's. However, with better access to sectoral data and the development of more sophisticated econometric models, recent studies have begun evaluating the exchange rate volatility-export connection from a sectoral perspective. The rationale behind this is that

BUBBLE IN THE INDIAN REAL ESTATE MARKETS: IDENTIFICATION USING REGIME-SWITCHING METHODOLOGY

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ABSTRACT

India has a growing economy that can support high-income levels and in turn sustain higher real estate prices. The high prices of Indian real estate seem to be in harmony with its fast growing economy. However, there are concerns about speculative bubble behavior in the Indian real estate market. In this paper, we utilize a sophisticated regime-switching speculative bubble model developed by van Norden and Schaller (1993) along with other traditional econometric methods to test for the presence of bubbles in the Indian real estate market. Our results provide evidence that India real estate bubble was not affected by the 2007-2008 global economic slowdown. The Indian Real Estate market grew from the end of 2008 through early 2011.

JEL: C22, C41, L85, R33

KEYWORDS: Indian Real Estate, Rational speculative bubbles, Regime-switching tests, duration dependence tests, REITs

INTRODUCTION

While the US and European housing markets are still struggling to recover from their pre-global final crisis of 2007-2008, the Indian housing market has recovered quickly from its 2007 slide. RESIDEX, an Index created by National Housing Bank (NHB) of India clearly indicates that except for a few small cities, the prices of real estate are significantly above pre-crisis levels. In H1 2011 prices in the four major Indian cities of Delhi, Mumbai, Kolkata, and Chennai rose 26%, 75%, 111%, and 118 %, respectively. The Reserve Bank of India - RBI (Central bank of India) observed the higher real estate prices and became concerned about a potentially damaging real estate bubble (Business Standards, July 2011).

The RBI based its concern on two trends: (1) the growth of non-performing assets in residential mortgages and that commercial real estate was at record high levels (2) teaser rates offered by Indian banks since 2009 may have over-stimulated loan demand. The teaser rates are set at fixed low rates for the first few years of the loan period and then, depending on the contract, the rate can become floating or remain fixed based on the State Bank Advance Rate – Benchmark Lending Rate. The RBI's main concern is that teaser rates may cause borrowers to default on loans when interest costs are increased. Jones Lang LaSalle, the leading Indian real estate consultants group has noted the higher level of risk and the bubble behavior of investors and borrowers.

Indian economists and policy makers believe that the current Indian real estate market demonstrates similarities to the U.S. real estate market shortly before the subprime mortgage crisis. However, policy makers do not consider the situation alarming at this point because of several factors. First, property prices in some Indian cities are much higher than the sustainable level of income but fast growing economy and rising income levels may be able support high real estate prices. Second, the cause of the real estate bubble burst in U.S. and other Western countries was the widespread bundling and sale of real estate mortgages in the form of financial derivatives. Financial derivatives are not available in the Indian

INTERNATIONAL VOLATILITY TRANSMISSION OF REIT RETURNS

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ABSTRACT

This study examines whether volatility of REIT returns can transmit across national borders. Two competing hypotheses are proposed. The first is the Transportable Risk Hypothesis which suggests geographic risk can be transmitted overseas if the general equity and real estate securities markets are integrated internationally. The second is the Non-Transportable Risk Hypothesis which argues that geographic risk factors are country-specific and therefore not transmittable across national borders. Using GARCH and EGARCH econometric models, international spillovers of volatility of REIT returns are found among United States, United Kingdom, and Japan. The finding has major implications for formulating international portfolio strategies as it improves forecasting ability. The finding also implies that better international portfolio diversification can be achieved with real estate securities from countries that have a lower degree of integration between the real estate sector and the general stock market.

JEL: C51**;** G11; G15

KEYWORDS: REIT volatility, multivariate GARCH, volatility spillovers, international portfolio diversification

INTRODUCTION

The progressive integration of international capital markets and the globalization of investor portfolios have provided the impetus to understand the dynamics of stock prices across national borders. Academic studies have found substantial evidence of transmission of stock returns volatility across international equity markets (e.g. King and Wadhwani (1990), Hamao, Masulis, and Ng (1990), Lin, Engle, and Ito (1994), Karolyi (1995), Bekaert and Harvey (1997)). The phenomenon of volatility transmission has also been found in currency markets (e.g. Melvin and Melvin (2003), Huang and Yang (2002), Kearney and Patton (2000)) and in futures markets (e.g. Gannon and Choi (1998), Franses et al. (1997), Najand et al. (1992)). Stevenson (2002) further documents the spillover of returns volatility from equity REITs to other classes of REITs in the United States. However, only few studies have investigated the spillover of volatility across international real estate securities. This study therefore examines the international transmission of REIT returns volatility using REITs of Japan, United Kingdom, and United States.

By applying Generalized Autoregressive Conditional Heteroscedasticity (GARCH) and Exponential GARCH (EGARCH) models, we find that there are significant international spillovers of REIT return volatility among the three countries. The geographic risk factors of a country affect volatility of REIT returns of other countries significantly. We also find that the volatility spillovers are symmetric. The negative news in one market does not increase volatility more than positive news in another market. Overall, our findings suggest that investors could benefit from international diversification by investing in real estate securities from countries that have a lower integration between their property sector and the general stock market.

CAPITAL STRUCTURE TIMING IN MARKETS WITH DIFFERENT CHARACTERISTICS

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ABSTRACT

Considerable empirical evidence suggests that firm's time equity issues to market movements and that this behavior impacts capital structures. Based on a survey of investigations of this phenomenon, this study observes capital structures in different financial markets and identifies different situations related to the effect of timing on leverage. This study also explains optimal leverage with a simplified dynamic adjusted model. Firms facing financial constraints in debt financing may increase equity issues resulting in considerable leverage variance. On the other hand, firms with fewer financial constraints can time the market when issuing equity. This study takes regional samples from the United Kingdom and Japan, to summarize circumstances involving partial financial constraints and no financial constraints. The market timing effects tests in the United Kingdom are insignificant but the results for Japan are significant. This phenomenon improves understanding of the market timing model under different circumstances.

JEL: G30; G31

KEYWORDS: Market Timing, Capital Structure.

INTRODUCTION

International capital structure is seldom examined, perhaps because of data limitations and insufficient methods for comparing different markets. This study investigates differences in financial market leverage and the impact of market timing on capital structure in markets with different characteristics. Pecking order and tradeoff theories are applied at static points and may lead to misleading leverage information. Consequently, some studies investigate capital structure also across different time periods. Opler and Titman (2001) stated that financial decisions include an optimal target debt ratio. Hovakimian and Titman (2001) used two stage regressions to conclude that firms adjust to an optimal target debt ratio that may change over time and be related to profitability and stock price. Baker and Wurgler (2002) used weighted market-to-book ratios as a proxy for the past impact of equity issuance on capital structure and declared that the market-to-book effect exerts a persistent and long lasting influence on capital structure.

The market timing effect on capital structures under different market characteristics reveals countries with similar characteristics but different financing patterns. This phenomenon can supply data for investigating whether weighted market-to-book ratios represent a good proxy for deviation between current and target debt ratios (Baker and Wurgler, 2002). The United Kingdon (UK) and Japan are chosen for examination in this study. Both countries belong to the G-7 and have similar market capitalization percentages, at around 80% (Rajan and Zingales, 1995). Firms from these countries have more financing via banks, meaning external financing is not fully reflected in their capital structure, or perhaps leverage can be adjusted to reach the target. This study proposes a simplified dynamic adjustment model, similar to that of Banrjee et al. (2000) to explain how leverage effects vary among markets.

The remainder of this paper is organizes as follows. The following section reviews the relevant literature. Next, the theory is presented. A discussion of the data and methodology and presentation of test results follows. The paper closes with some concluding comments.

THE CONSOLIDATION OF THE GLOBAL BREWING INDUSTRY AND WEALTH EFFECTS FROM MERGERS AND ACQUISITIONS

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ABSTRACT

The brewing industry has recently experienced increased merger activity. This paper analyzes the short-term wealth effects of horizontal mergers and acquisitions on acquirers in the brewing industry. Based on a sample of 69 takeover announcements between 1998 and 2010, significant positive announcement returns were identified. In addition, the study finds significant positive returns for domestic transactions as well as cross-border deals involving targets in emerging markets. Other identified drivers of short-term success include transaction size, acquirer size and the target's public status. Furthermore, significant negative rival effects are identified across leading brewing groups, when missing a potential M&A opportunity.

JEL: G14, G34, Q14

KEYWORDS: Mergers and Acquisitions, Brewing Industry, Announcement Returns, Acquirers, Industry Rivals, Event Study

INTRODUCTION

Over the last decades, the wealth implications of mergers and acquisitions (M&A) have been widely discussed in empirical M&A research.Studies focusing on short-term announcement effects unambiguously conclude that M&A create value for shareholders of target companies (Bradley et al., 1988). However, the situation is not as clear-cut, as a closer look at returns to acquiring companies shows a different pattern: While overall acquirer returns average around zero (Bruner, 2002), industry specific event studies provide mixed findings of negative abnormal acquirer returns, positive abnormal returns or acquirer returns that are not significantly different from zero. Besides measuring the performance of the merging firms, there is also growing interest in the wealth effects of M&A on other firms from the same industry. Existing evidence shows that rival companies gain at the M&A announcement due to positive information signaling effects (See Eckbo (1983), Fee and Thomas (2004), Sharur (2005), Song and Walking (2000)). Towards the turn of the last century, many industries including the brewing industry,

have experienced a sharp increase in M&A activity. Consolidation has and continues to be a major trend in the sector as multi-national breweries seek to expand their activities into new emerging markets. At the same time, declining mature markets (in particular Western Europe) and resulting pressure on profit margins have encouraged brewers to engage in M&A, in order to gain in scale and benefit from synergies. In contrast to many other sectors, the production, distribution and marketing of beer is characterized by a relatively high fixed cost base, resulting in high levels of operational leverage (Earlam et al., 2010) providing larger brewers with material size advantages. Moreover, increased size has enabled brewers to exercise a significant amount of market-power (Schwankl, 2008), as larger brewers are able to negotiate favorable terms with their suppliers and benefit from greater bargaining power for negotiations with retail customers. Hence, it is not surprising that the global beer market today is dominated by large national/multinational brewers rather than local, regional brewers. The four largest brewers Anheuser-Busch Inbev, Heineken, SABMiller and Carlsberg ("the big four") control about 50% of the global beer

WHEN DO COSTA RICA NATIONAL BANKS RESPOND TO RESERVE REQUIREMENT CHANGES?

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ABSTRACT

The process of changing reserve requirements in Costa Rica is a three step process. First the central bank makes the decision to change reserve requirements. Several days to several weeks later, the change is announced in the official newspaper. The actual reserve requirement change takes place from several weeks to several months later. Previous studies have limited their analysis to an examination of the decision and the announcement dates. The research shows that Costa Rica national banks do not respond to reserve requirement change announcements or reserve requirement change decisions. In this paper we examine the extent to which Costa Rica national banks respond to reserve requirement changes on the effective day of the reserve requirement change. We find evidence that Costa Rica national banks change their interest rate spreads on the effective day.

JEL: E42, E58

KEYWORDS: Reserve Requirements, Banking, Costa Rica, Interest Rates

INTRODUCTION

Reserve requirement changes have been extensively examined in U.S. markets. Far less is known about responses to reserve requirement changes in other countries. This paper examines Costa Rica national bank responses to reserve requirement changes. Costa Rica provides a unique setting for examining responses to reserve requirement changes for four reasons. First while geographically small, Costa Rica is home to three of the ten largest Central American banks. Costa Rica has about 28 percent of Central American Bank Assets (Ballestero and Martinez, 2007). Second, Costa Rica banks accept deposits and make loans both in U.S. dollars and colon, the local currency. Banks hold reserves against deposits in both currencies, but reserve requirements have sometimes been different for deposits in the two currencies. Moreover, reserve requirement changes do not always coincide. Third, the Costa Rica Central Bank made ten reserve requirement change announcements between 1996 and 2010. These announcements made 18 changes of colon denominated deposit reserve requirements and ten changes of dollar denominated reserve requirements. By comparison, the most recent reserve requirement change in the United States occurred in 1992. Finally, Costa Rica has both government sponsored banks and privately owned banks providing a rich environment to study responses of various institution classes to regulation changes.

The process of implementing a reserve requirement change in Costa Rica starts with the decision by the Central Bank to change rates. Several days (sometimes several weeks) later the decision becomes public. The public announcement appears in the official Costa Rica Newspaper, *La Gaceta*. A lag of several days to several months occurs between the announcement date and the effective date of the change. This sequence of events is depicted in Figure 1.

The motivation for this study emanates from earlier work which finds that Costa Rica national banks do not respond to reserve requirement change announcements (Stewart, Jalbert and Jalbert, 2008, 2010). One plausible explanation for the lack of response is that reserve requirement change information is

MARKET COMPETITION AND MERGERS IN PROFESSIONAL SERVICE FIRMS

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ABSTRACT

This study examines competition level and merger in Taiwanese audit industry over a long time interval of 1992-2008. Total public accounting firms are divided into four sub-samples in terms of market segment, including big, large, medium, and small firms. Next, based on prior studies and service attribute, this study establishes four practice sub-markets: auditing, tax, consultation, and accounting. Empirical results indicate that big firms have the highest competition level but the other three sub-samples show no significant differences in competition level. Next, the auditing, tax, and accounting sub-markets become more concentrated over time but consultation sub-market does not change significantly. Big firms exhibit the highest competition level in the four sub-markets and four sub-markets but achieve the best in three financial performance measures, net profit per partner, profit ratio, and productivity per employee. Post-merger firms financially outperform pre-merger firms for Taiwanese two big firms' mergers occurred in 1999 and 2003.

JEL: M42

KEYWORDS: Market Competition, Herfindahl-Hirschman Index, Operating Performance, Public Accounting Firms

INTRODUCTION

The global economy is changing from an industry-based to a knowledge-intensive landscape which transforms the basis of technological innovation and corporate competition (Drucker, 1994; Van de Ven, 2004). Public accounting firms (also referred to as audit firms) are a professional service organization and a knowledge-intensive entity. Following the Enron debacle, the world largest public accounting firms then, Arthur Andersen, dissolved in 2002. This caused its Taiwanese affiliate firm to combine with that of Deloitte & Touche and created the largest public accounting firm in Taiwan, Deloitte Touche Tohmatsu, in 2003. Previous research indicates that regulatory agencies are concerned about market concentration and closely monitor any mergers between large public accounting firms due to increased post-merger audit market concentration (e.g., McMeeking, Peasnell and Pope, 2007). For example, in its 2008 report on market concentration for audits of public company, the U.S. Government Accountability Office indicated that the market concentration at that time lacked significant adverse concentration effect required for immediate action (GAO, 2008). In theory, a high market concentration level denotes low competition in a market (Besanko, Dranove and Shanley, 2000). Information about market concentration of service industry is useful to governmental agencies, companies, and academics alike (Wernerheim, 2010). Because of regulations, mergers between firms, and economic development, market concentration levels change over time (Jennequin, 2008). Previous studies typically focus on the short-term or discrete audit market concentration, which motivates this study to examine the long-term concentration to fill the gap left.

Prior studies document the existence of market segmentation in the audit market owing to government regulations or the size of clients served (DeFond, Francis and Wong, 2000; Ghosh and Lustgarten, 2006). Public accounting firms are often categorized in terms of their size, service area, or practices offered. Market segmentation leads to varied market concentrations in different public accounting firm categories. Base on prior studies (Ghosh and Lustgarten, 2006; Chen, Chang and Lee, 2008), this study partitions total public accounting firms into four sub-samples to better reflect audit market attributes. The first purpose of this study is to examine the long-term audit market concentration for each

AFTERMARKET RISK AND UNDERPRICING OF INITIAL PUBLIC OFFERS IN THE ARABIAN GULF COUNTRIES: AN EMPIRICAL ANALYSIS

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ABSTRACT

The recent evidence has shown that IPO uncertainty continues in aftermarket until a normal market is established. Evidence also indicates that aftermarket risk measured by stock's beta is related to the degree of underpricing in the US market. This may imply that additional underpricing may be required to compensate for aftermarket risk, assuming that the aftermarket risk is important for the investors who want to buy primary shares from the public offers and/or aftermarket trading. Therefore, we examine the relationship between aftermarket risk and underpricing by using data from six Arabian Gulf countries, an economic region where all personal incomes including capital gains are tax-free. The evidence based on 147 samples depicts that IPO firm's aftermarket risk measured by stock's beta has significant relationship with the degree of underpricing. Thereby, it is confirmed that the relationship between aftermarket risk and underpricing also exists in the Arabian Gulf countries, an important economic region outside the US. Paper concludes that that underwriters and/or issuers may need to forecast the expected aftermarket risk while determining the offer price.

JEL: G30 and G32

KEY WORDS: IPO Underpricing, Aftermarket Risk, and Arabian Gulf Markets

INTRODUCTION

The underpricing of initial public offers (IPO) is a global phenomenon that has been investigated by numerous researchers from different dimensions of underpricing (see Loughran *et al.,* 1994 for global evidence on IPO underpricing and Jenkinson and Ljungqvist (2001) for a critical review of the vast IPO literature). Researchers offer several theories suggesting that underpricing is inevitable due to information asymmetry among the parties involved in IPO process. These include winner's curse theory (Rock, 1986); signaling theory (Allen and Faulhaber, 1989; and Grinblatt and Hwang, 1989); and price delegation theory (Baron, 1982). In addition, researchers have offered explanation of underpricing in the light of institutional factors, such as underwriter price supports and pre-issue information gathering (Ruud, 1993; and Benveniste and Spindt, 1989), need for ownership dispersion and secondary market liquidity (Brennan and Frank, 1997; Bodnaruk *et. al*., 2008; and Booth and Chua, 1996), and listing delay after offer pricing, (Chowdhry and Sherman, 1996). Explanations of underpricing also appear with respect to fads and divergence of opinion in primary market (Aggarwal and Rivoli, 1990; Miller, 1977; and Gao *et. al*., 2006). Of these theories, many of them have basically considered an ideal market condition while explaining IPO underpricing as an equilibrium phenomenon due to ex-ante uncertainty in primary market.

Plenty of empirical studies have examined IPO underpricing across the world, and found evidence of ex-ante uncertainty in the primary markets using numerous proxy variables, but recent evidence has found that market uncertainty continues in the aftermarket period until normal market is established (Chen and Wilhelm, 2008 and Falconieri, *et. al*., 2009). Evidence is also found that IPO aftermarket beta and initial underpricing are correlated in the US (Gleason, *et. al.,* 2008). These findings may imply that underpricing is needed to compensate IPO aftermarket risks in addition to ex-ante uncertainty if investors want to buy shares from the public offers and/or aftermarket trading. Therefore, the evidence of correlation between

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