

# INTI INTERNATIONAL UNIVERSITY

## MASTER OF BUSINESS ADMINISTRATION

### Analyst Recommendations and Financing Decisions of Public Listed Companies

Author: TIEW WAN YING

FOR REFERENCE ONLY

Student No: I12002029

Supervisor: MR. LEE CHIN CHONG

Submission Date: 14 NOVEMBER 2013

Ethics Number:

Final Word Count: 17, 222 words



HD  
37  
T11  
2013

Faculty of Business, Communications and Law

## ABSTRACT

This research is aim to examine the optimistic level of recommendations which provided by financial analysts in Malaysia. Therefore, this study focusing to find out the optimistic level, accuracy level and the market reactions in corresponding towards the recommendations which provided by independent analyst and sell-side analysts. The scope of research is focus on Bursa Malaysia and the target of sample research is the public listed companies which had announced equity financing issues. Firstly, to examine the difference between sell-side analysts' recommendations and independent analysts' recommendations, independent T-test was used to conduct the equality means test of recommendation between the two groups of analysts. The result indicates that there is no significant difference of recommendations from both groups of analysts, but the mean value shows that they tend to issue optimistic recommendations. Secondly, to examine the accuracy level of forecast error from sell-side analysts and independent analysts, independent T-test was used to conduct equality means test. The findings show that there is no significant difference between two groups of analysts. Lastly, to find out the market reactions towards the recommendations from both group of analysts, the average abnormal return (AAR) and cumulative average abnormal return (CAAR) was used to measure the response of investors. The results show that the investors respond positively towards hold recommendation from independent analysts and sell recommendation from sell-side analysts. Overall, the findings on this study suggest that the recommendations by both groups of analysts are considered optimistic and to have similar accuracy level of forecast errors, but lack of evidence to support that the main indicator is information asymmetry. Besides that, the market is actively respond to recommendations from analysts especially sell recommendation from sell-side analysts and hold recommendation from independent analysts.

## ACKNOWLEDGMENT

This research has brought me a very useful and valuable experience where I was able to learn new knowledge and also to learn a lesson of smart time management skill. Within the limited time frame, it will never be an easy job to complete this interesting yet challenging research topic. Therefore, this dissertation will be a "mission impossible" without the kind-hearted assist from few important people.

First of all, I am deeply indebted to my supervisor, Mr. Lee Chin Chong, for all his guidance, inspiration, patience and support. He is always generously to provide valuable suggestions and advises throughout the process of completing this thesis. Without his strictness and seriousness attitude, this research dissertation would forever be a "mission impossible".

Secondly, I would like to express my deepest appreciation and gratitude to peer scholars for their willingness to share their knowledge and provide suggestions to add value on my thesis. Without their generous input, this research dissertation would be less lively.

Finally, my deepest heartfelt gratitude and appreciation to my parents and family, for their continuous encouragement and everlasting love. I am feeling indebted to my parents who morally and financially support me throughout whole year of MBA study life. This thesis could be the dedication for their unconditional love, support and generosity.



## DECLARATION

I hereby declare that this thesis is based on my original work and I have acknowledged all the material and sources used in the preparation of this thesis. I also declare that this work has not been previously or concurrently submitted for any master degree at INTI International University or other institutions.

Date: 14<sup>th</sup> November 2013

---

Name: TIEW WAN YING

ID No: I12002029

## TABLE OF CONTENTS

Abstract .....	I
Acknowledgment .....	II
Declaration .....	III
Table of Contents .....	IV
List of Figure .....	VII
List of Table .....	VIII
Chapter I Introduction.....	1
1.0 Introduction .....	1
1.1 Background of Study.....	3
1.2 Problem Definition.....	7
1.3 Research Questions.....	9
1.4 Research Objectives .....	9
1.5 Significance of Study.....	10
1.6 Scope of Study.....	11
1.7 Limitations of Study.....	11
1.8 Chapter Summary .....	12
Chapter II Literature Review.....	13
2.0 Introduction .....	13
2.1 The Financing Option.....	13
2.2 The Role of Financial Analysts.....	15
2.2.1 Sell-side Analysts .....	16
2.2.2 Independent Analysts .....	17
2.3 The Role of Investment Bank in Malaysian Financial Market.....	18
2.4 Underwriting Relationship .....	19
2.5 The Optimistic Level of Recommendations.....	20
2.6 The Accuracy Level of Recommendations.....	24

2.7	Market Reactions towards Recommendations.....	26
2.8	Hypotheses Development.....	29
2.8.1	Hypothesis One.....	29
2.8.2	Hypothesis Two.....	30
2.8.3	Hypothesis Three, Four, Five and Six.....	30
2.9	Chapter Summary.....	32
Chapter III	Research Methodology.....	33
3.0	Introduction.....	33
3.1	Research Design.....	33
3.2	Research Approach.....	34
3.3	Target Population, Sampling Technique and Sample Size.....	34
3.4	Data Collection.....	36
3.5	Data Analysis.....	41
3.6	Chapter Summary.....	42
Chapter IV	Findings and Analysis.....	43
4.0	Introduction.....	43
4.1	Overview on Sample Selected.....	43
4.2	Optimistic Level of Stock Recommendations.....	45
4.3	Accuracy of Stock Recommendations.....	49
4.4	Market Reactions towards Stock Recommendation.....	51
4.4.1	Market Reactions towards Stock Recommendations by Independent Analysts.....	51
4.4.2	Market Reactions towards Stock Recommendations by Sell-side Analysts.....	57
4.5	Summary of Hypotheses Testing.....	63
4.6	Chapter Summary.....	64
Chapter V	Discussions, Conclusions, Recommendations and Personal Reflection.....	65
5.0	Introduction.....	65
5.1	Discussions and Analysis.....	65

5.1.1 Discussions on optimistic level of stock recommendations.....	66
5.1.2 Discussions on accuracy level of stock recommendations .....	68
5.1.3 Discussions on market reactions towards stock recommendations.	69
5.2 Conclusions .....	72
5.3 Practical Implications .....	73
5.4 Recommendations .....	74
5.5 Personal Reflection .....	75
<b>References</b> .....	<b>76</b>
<b>Appendices</b> .....	<b>85</b>

## LIST OF FIGURE

Figure 2-1: Simple illustration of firm vs. industry analysts.....16



## LIST OF TABLE

Table 3-1: Summary of Research Design .....	33
Table 4-1: Number of Companies that Meet the Sampling Criteria .....	44
Table 4-2: Distribution of Companies that Meet the Sampling Criteria by Sectors .....	44
Table 4-3: Comparison of Recommendations between Independent Analysts and Sell-side Analysts for Equality Test .....	46
Table 4-4: Comparison of Recommendations between Independent Analysts and Sell-side Analysts for Zero Value Test .....	47
Table 4-5: Distribution of Recommendations from Independent Analysts and Sell-side Analysts .....	48
Table 4-6: Distribution of Recommendations from Independent Analysts and Sell-side Analysts by Yearly Basis .....	48
Table 4-7: Frequency of Events by Independent Analysts and Sell-side analysts .....	49
Table 4-8: Comparison of Forecast Error between Independent Analysts and Sell-side analysts .....	50
Table 4-9: Average Abnormal Return for Independent Analysts' Recommendations .....	54
Table 4-10: Cumulative Average Abnormal Return for Independent Analysts' Recommendations .....	55
Table 4-11: Average Abnormal Return for Sell-side Analysts' Recommendations .....	60
Table 4-12: Cumulative Average Abnormal Return for Sell-side Analysts' Recommendations .....	61
Table 4-13: Summary of Hypotheses Testing .....	63

# CHAPTER I

## INTRODUCTION

### 1.0 Introduction

Under macro environment, the governments, firm players and household players are the three major players in the financial market. These three parties can form a triangle relationship. The governments can be the lenders or borrowers; the firm players are the demander of capital and the household players are the suppliers of capital (Bodie et al., 2013).

From the perspective of firm players, they need the extra source of capital to expand their growth and also to add value to their synergy resources. Therefore, the firm will raise fund by equity financing or debt financing. As stated by Myers and Majluf (1984), a firm raises fund through common stock issuing in order to undertake valuable investment opportunity. They assume that management is able to get more insider information comparing to potential investors. The model presented in their study explains the behavior of corporate financing by firms which they are more relying on internal fund sources and prefer debt financing.

When the public listed companies need to raise capital, they will choose to increase borrowing or look for seasoned equity offer. Seasoned Equity Offering (SEO) occurs when the particular firm experience high trading volume and price stability. Upon financing decision of SEO, the firm can choose to rights offer or public cash offer. In Malaysia, most companies would choose right offering as it is a form that gives preemptive right to existing shareholder to purchase new issued shares and has no impact on stake holdings. Thus, in theoretically, the effect of right on shareholder's wealth is neutral. Public cash offering refers to



issue new shares to the public and imbalance would happen if the new investors buy the new shares in cheaper price than the existing shareholders.

During the process of raising capital in Malaysia, investment banks playing a critical role in leading on the underwriting events and coordinating the formation of underwriting under legal legislation condition. Here, the financial analysts who work with underwriter company playing a intermediate role to provide fair and objective analysis about the bonds and equities from that particular company. The analysis includes fundamental analysis, technical analysis and the historical performance of that particular company. In this process, there will be including of struggling issues such as conflict of interest and asymmetric information. One of underwriting company's duties is to help to promote and sell the bond or equities during the issuing event. Therefore, the process will involve agency issue and the integrity of analysts in order to protect own firm's profits and the interest of that particular company.

Asymmetric information refers to a situation where one side has the superior information comparing to another during the process. In security market, information asymmetric own by one side which means that they have the insider information of the listed companies and thus they have the advantage during making investment decision. However, with the advancement of technologies nowadays, people are able to gain information in various ways in World Wide Web.

In common sense, those investors who anticipate in the financial markets are reasoning to aim for excessive returns from their modal investments. In fact, the financial markets are highly competitive and the stock market game composites with no free-lunch rules. The investment is always associated with risk and return. Therefore, the financial markets are well prepared with thousands of financial analysts in the back and constantly searching for the best buy (Bodie et al., 2013).

For household players, they need motivation and guidelines to make confidence investment decision. One of the sources of illegal motivation is the recommendations or analysis report by professional financial analysts. In security market, recommendation refers to the professional judgment on the specific stock by financial analyst after process of analyzing and also inclusive of expectation for future. The expectation could be the appreciation or depreciation of that stock value in the market and the recommendation could have impact to stock prices and the market's rationality (Martinez, 2011).

### 1.1 Background of Study

As stated by the deputy chief from Securities Commissions (SC), Datuk Ramlah Mahmood, the size of Malaysia's market capitalization has grown triple up to RM2.5 trillion since 2000 and it is equivalent to 264% of country's GDP. In Bursa Malaysia, the market capitalisation is RM1.6 trillion. Other than that, the Employees Provident Fund has achieved to RM536.5 billion in assets and funds under well management which was ranked the sixth largest pension fund in the world (Star Publication, 2013).

Besides that, Malaysian government always encourage and provide opportunities to small companies known as small-to-medium enterprises (SME) because these small companies are usually the driving force behind economies where they create job opportunities, generate wealth and stimulate the supply-chain demand. When the companies have reached to appropriate size for public market, Bursa Malaysia will provide them the first avenue in ACE market which now has 110 listed companies. Then, the successful ACE companies can be qualified to move into the Main market. Currently, Bursa Malaysia had ranked over 900 listed companies in board according to market capitalisation and found out that 50% of the bottom list had make of 1.62% of Bursa market capitalization, while the 85% had accountable by the top 10 companies (Star Publication, 2013).



According to Zurairi (2013), the international analysts from the Centre for Economics and Business Research (CEBR) stated that there is potential bubble risk under the Malaysia's stock market environment as the possible impact from current global thirst through unsustainable growth. However, they expect a healthy growth outlook for Malaysia as there is still remain positive growth. They encouraged having careful judgment in order to ensure stable capital inflows as the foundation layer for future instead of creating bubble.

Erel, et al., (2012) stated that macroeconomic conditions are the critical cause element for a company to raise capital. During economic downturn, private placements of equity and debt are the only manner way of capital funding for those companies. When the economic tend to be slowdown, the investors would seek to switch to lower risk investment and this will lead to scarce capital issue.

For public listed company, equity financing can be one of the ways to raise fund. Right issue refers to the privilege right granted for existing shareholders to directly purchase the shares from the issuing company. The shareholder will be offered the right to buy issued ordinary shares directly in proportion to the number of shares that currently owned. The reasons of a company to raise additional capital through right issue are to expand business and to repay the loan facilities. Besides that, right issue provide the opportunities to the existing shareholders to purchase the additional shares at discounted market price and to cultivate the shareholders' interest in the company (Institut Bank-Bank Malaysia, 2010).

In France, there is the latest research to investigate the impact of market liquidity on SEO characteristics. They find out that blockholder renouncement to subscribe new shares and market liquidity are the critical determinants of flotation method. High liquidity firms will choose to standby rights or pure public offerings, whereas low liquidity firms choose to mixed public offerings or uninsured rights (Ginglinger, et al., 2013).

In reality, when a listing company announces to issue right offer, the different reactions can be identify in public because different people will get different type of signaling effect. Seasoned Equity Offering (SEO) refers to sell the right issue to existing shareholders. Within the equity offering process, the investors in market are concern with the agency issue. Sometime, they tend to perceive negatively that the price for new rights is overvalue because that particular company management tends to protect the interest of shareholder.

For an investor, portfolio is the collection of investment assets. The investor would "rebalance" or update the portfolio by selling existing securities or buy in by investing in any securities to increase the portfolio's capacity. Furthermore, the security analysis is necessary for an investor as it help to provide detail evaluation whether on broaden view or narrow view. The security analysis inclusive of valuation of securities and the evaluation of analysis could be on fundamentally or technically (Bodie, et al., 2013). In fact, information asymmetry could be the advantage or incentive for them during making investment decision.

The security analysis belongs to job under professional analysts. Other than that, the analyst is also playing their role to reduce the gap between public listed company and investor by providing recommendations. In today's market, analysts can be important informative sources and investors should aware of the potential conflict of interest from analysts. There are few types grouping of financial analysts including sell-side analysts, buy-side analysts and independent analysts. Sell-side analysts work for broker dealers and make recommendations on the securities under their coverage. Buy-side analysts work under mutual funds or institutional money managers who provide advice to employers. Independent analysts are not associated with any firms or funds and they aim to provide unbiased research report. Normally, the compensation for independent analysts is on subscription base or fee base (Wall Street, 2011).

Cotterell (2011) in South Africa examine the influence of right issues announcements on the share price performance. His study conclude that the market respond negatively to the right issues announcement from the firms



which it relate to the financial position of the issuer. From this point of view, it can seem that the market concern to the information asymmetry which they able to know the potential financial stretch.

In fact, a firm issue common stock to raise fund and also to undertake valuable investment opportunity. It is assumed that the management able to gain insider information than other potential investors. Thus, there is asymmetric information appear between the firms and other potential investors (Myers and Majluf, 1984). In this case, stock recommendation able to reduce the information gap between management and potential investors.

According to Agrawal and Chen (2008), conflict of interest by investment bank will lead the analyst to issue more optimistic recommendation and thus the bias view is convey to the investors. However, the evidence research from 1990s stock market bubble shows that the investors able to discount the opinion from analysts in order to avoid any mislead case.

In somehow, the affiliated analysts will tend to issue less optimistic recommendation when there is competition exists in the market. This may be due to the affiliated analysts are more concern to the reputation of firm as their priority and also to take care of client relation. In contrast, some unaffiliated analysts or sell-side analysts tend to issue more optimistic recommendation because they want to enjoy the incentive gain in the process of trading (eg., Sette, 2011; Cowen et al., 2006).

However, certain investors are able to discounted the opinion from analysts to avoid any losses due to conflict of interest from analysts' firms. The investors in the market highly recognize great performing analysts or star analysts and tend to follow their revision of advice. There are study has proved that historical performance and length of analysts' track record are the indicators for the investors to pick to follow whose recommendation advice (eg., Mikhail et al., 2004; Agrawal and Chen, 2008).