STRONG FORM EFFICIENT MARKET HYPOTHESIS: A STUDY OF ABNORMAL RETURNS BEFORE THE ANNOUNCEMENT OF RIGHTS ISSUE

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ABSTRACT

This study examines activities before corporate actions occur. It aims to determine if private information affects a rights issue before its announcement. If the rights issue announcement does not provide information, investors cannot use it to obtain abnormal returns. This makes the time vulnerable to institutional ownership of private information that can affect the value of the firm. The sample was selected purposefully, and the market-adjusted model was used for measurement. The study found that abnormal returns occurred before the right issue announcement, implying that private information has a significant impact on abnormal returns. Positive abnormal returns may indicate that investors perceive the rights issue as positive news, possibly signaling confidence in the future. This effect was observed only when the information was deemed valid for investors. Additionally, institutional ownership was found to have no significant effect on abnormal returns. The study on how institutional ownership affects abnormal returns does not have a large impact because this variable is often based on confidential information that is only available to the company's internal parties. A concern arises when new shares are offered through Pre-emptive Rights, which usually happens due to the existence of private information.

Keywords: Right Issue, Abnormal Return, Private Information, Institutional Ownership

INTRODUCTION

Corporate action is a company decision that will impact firm value. Even the corporate actions carried out by this company can have an impact. Every issue that has impacted the company regarding corporate action is of particular concern to investors in the capital market. One definite thing that investors will do is reevaluate the impact of this corporate action on the company's value in the future. Pratama (2014) defines the capital market as a platform where those with funds come together. On the Indonesian Stock Exchange, the manufacturing industry is one of the drivers of the country's economy. As such, it presents numerous investment opportunities for potential investors. However, the challenge lies in market participants' passivity in filtering relevant information, which makes it difficult for them to invest. This inability to filter information ultimately leads to misunderstandings and misaligned investment decisions. The occurrence of information misinterpretation is beneficial in testing the strong form of the efficient market hypothesis, wherein stock prices reflect all publicly available information. One-sided information control or the presence of private information may lead to vulnerability in this phenomenon, influencing the assessment of firm value. Some previous research by Layuk and Yednya (2018) indicates a considerable variation in the TAT (total assets turnover) ratio pre and post-bankruptcy. Similarly, a significant difference in the TAT ratio has observed before and after the right issue. According to research conducted by Putra and Dewi in 2013, the announcement of the right issue did not have a significant effect on abnormal returns but had a significant effect on stock trading volume. In addition, a previous study on the efficient market hypothesis in Indonesia by Dwipayana and Wiksuana (2017) showed that the Indonesia Stock Exchange is efficient in the form of half-strong informational efficiency since the announcement of dividends affected the price with the presence of abnormal returns, but not significantly, and did not continue to affect the market price. Previous research shows that there is an impact of corporate action on companies. Analysis of dividend policy, mergers/acquisitions, issuance of new shares, stock splits, and other corporate action phenomena provides varied results. Several previous studies on mergers and acquisitions show positive abnormal stock returns by Saiful (2003), Bendeck and Waller (2007), McGowan and Sulong (2008), and Wong and Cheung (2009). Nisak (2015) shows that three days before the announcement of stock prices affected stock prices. Otieno and Ochieng (2015) stated that the announcement of a rights issue had a negative effect on stock returns.

THE EFFICIENT MARKET HYPOTHESIS

Strong-form efficient markets state that prices reflect all available information, both public information and private information. So, in this case, the strong form includes all relevant historical information and also relevant public information, as well as information that is only known by a few parties, such as company management, board of directors, and creditors. The efficient market hypothesis by Fama in 1970 states that the market will be said to be efficient if the prices formed in the market are a reflection of existing information According to Fama (1970) form of the efficient market can be grouped into three, known as the efficient market hypothesis. The three forms of efficient markets are (1) had the weak eyes form of the efficient market hypothesis, (2) semi-strong form of the efficient market hypothesis, and (3) strong form of the efficient market hypothesis. Each of the forms of the efficient market is closely related with as far as where the absorption of information occurred in the market. In general, market efficiency is defined by Beaver (1981) as the relationship between prices and prices. The concept of an efficient market is inextricably linked to the extent and speed with which information can affect the market. Information can affect the market, which is reflected in changes in security prices. Haugen, (2001) divided into three information groups, namely (1) information in good past stock prices, (2) all public information, and (3) all available 5 information including inside or private information.
Gajewski and Glinglinger (2002) and Shahid et al. (2010) examined the right issue announcement event show that the abnormal return of the right issue announcement is higher than that of the right issue announcement. The study show that the abnormal return is significantly different around the right issue announcement. Sri's (2009) shows that there is a change in abnormal returns due to

the right issue price adjustment. Ramesh and Rajumesh (2014) show that information is absorbed quickly through market participation. Agarwal, & Mohanty (2012) explain that the Right Issue has an impact on Stock Return in India.
H1: There are differences in returns are proxied by abnormal returns before and after the rights issue
Private information is specific information that is known only to company insiders, or investors who have relationships with company insiders who know the condition of the company in detail. As emphasized by Bond et al. (2012), firm insiders are parties who have more information about the state of the firm. Transactions, where one party has better information than the other (Arrow, 1985), show that this condition means that information is not distributed equally, which is then known as information imbalance. This is what French & Roll (1986) call private information. Private information has the consequence of adverse selection, i.e, parties with better information can use the information to gain advantages and investors only can obtain abnormal returns if they have private information (French & Roll, 1986).
H2: There is an effect of private information on abnormal returns before the announcement of the rights issue

CORPORATE ACTION

A corporate action is generally defined as any type of event or decision that leads to a significant material change in the company. The implementation of a corporate action normally has an impact on shareholders and others who have a substantial stake in the success of the corporation. In the best scenarios associated with this action, all parties involved benefit from the implementation of the action. From this definition it can be noted that corporate action occurs because of material changes which result in changes in the share ownership structure which will be different from before. This change was carried out by the management of a public firm in order to increase the value of the firm and the price of the firm's securities as a strategic step for the firmin facing intense and pressured business competition. Without corporate action, stock prices circulating on the IDX are like suspended animation and stop, with no demand and weak supply, which in the end can weaken the price value of companies listed on the IDX, which in the long term can and will actually slow down the availability of funds. fresh and new for national development, through investment in the capital market. By using the above as a point of view, it can be understood that the general aim of corporate action is to increase the capital of public companies, increase stock trading liquidity, and other economic targets. Other specific objectives of corporate action include income distribution, purchasing or paying off debt, increasing capital, restructuring capital, controlling and supervising the firm, increasing liquidity, restructuring debt obligations by issuing new stocks (rights issue). Adhering to this, the aim of corporate action is to direct the firm's perfomance in its efforts to survive and develop its business expansion, which clearly requires large amounts of capital. This means that even though the change in legal status has changed to a public firm, which was followed by the listing of its stocks on the IDX and some of its stocks are owned by the public, after obtaining funds from the public it does not mean that this business institution simply stops trying to be able to raise funds again from the public. Still need more funds to be able to run the business (after the public offering of stocks) further.

PRIVATE INFROMATION

Private Information is specific information that is only known by internal companies or investors who have relationships with internal companies who know the firm's condition in detail. As emphasized by Bond et al. (2012) firm insiders are parties who have more information about the condition of the firm. Transactions in which one party has better information than the other (Arrow, 1985) indicate that this condition means that information is not distributed equally, which is then known as information imbalance. This is what is meant by personal information (private information) by French & Roll (1986). Private information has the consequence of adverse selection, namely that parties who have better information can utilize this information to reap profits and investors only have the possibility of getting abnormal returns if they have private information (French & Roll, 1986). The first related factors are capital allocation efficiency which is positively correlated with the amount of firm-specific information on Wurgler (2000) stock returns. Durnev et al. (2004) find support for the prediction that more informative stock prices should improve capital budgeting decisions. Second is the firm's operational performance, private information is related to the firm's future operational performance. This evidence suggests that private information conveyed by stock prices allows managers to learn about the fundamentals of their companies and improve managerial corporate investment decisions. Theoretically, there are several ways to measure private information, namely variations in stock returns, illiquidity, and PIN. Measuring private information using the stock return variation method presented by Roll (1988) found that the level of informativeness of stock prices as measured by firm-specific stock return variations strengthens the relationship between abnormal stock returns and dividend changes. Both public information and private information can help companies optimize dividend payments. This measure, first developed by Roll (1988), reflects variations in stock returns that cannot be explained by the market or industry.

RESEARCH METHOD

The population for this study are companies on the Indonesia Stock Exchange that carried out right-issue activities. According to the population data, 114 companies listed on the Indonesia Stock Exchange underwent corporate action policies in the form of right issues. The sample was obtained through purposive sampling to ensure that only companies meeting the research criteria were included. Observations were conducted during the 30 days preceding the announcement (H-30) and on the day of the announcement (event date H=0). The study's data analysis applies event study analysis to determine if companies listed on the Indonesia Stock Exchange experience abnormal returns before the announcement of the right issues. The event study analysis utilizes the market-adjusted model in the cross-section. Research Model :

$$ARt = a + b1PrivInf + b2InOwn + e$$

where:
ARt represents firm value, PrivInf represents managerial ownership, and InOwn = Institutional ownership
The sample in this study is the abnormal return before the right issue day.

PRE-CORPORATE ACTION ANALYSIS AND ABNORMAL RETURN

The right issue is a method of funding a firm that uses its capital as an alternative policy. Pre-ordering is a type of rights issue. Issuing new stocks with the Right Issue mechanism always results in an impact on the firm's stock price. This occurs because the price of new stocks is always lower than the market stock price. However, this does not imply that Pre-emptive Rights are unfavorable news for stockholders. Like other corporate actions, the topic of Pre-emptive Rights is typically announced well in advance of being approved at the general meeting of stockholders. The following graph presents a summary of the stockholder response to the Pre-emptive Rights matter.

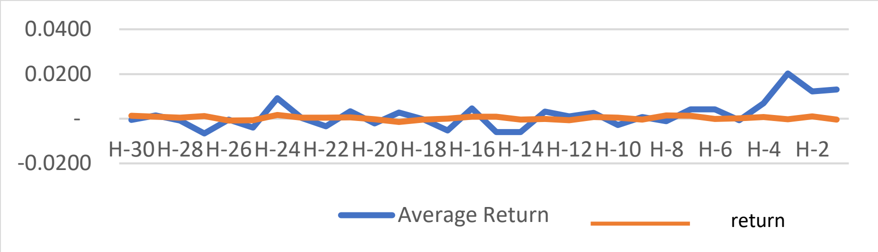

Figure 1. Average Return 30 Days Pre-Corporate Action Right Issue

There was a rise in the firm's stock return in the 30 days before the right issue decision was made. The uptrend gained momentum before the Pre-emptive Rights were introduced in the stockholder meeting, as evidenced by an increase at H-5, followed by a decrease at H-3. The reduction was a natural corrective phase resulting from profit-taking, never falling below the earlier upswing. H-2 recorded a slight movement, while there was a gentle trend at H-1. This test for abnormal returns initiates with calculating the closing price-based stock returns. Subsequently, the expected return is computed to determine the market return's fairness and to compare it with the obtained return for conformity with the anticipated return standard.

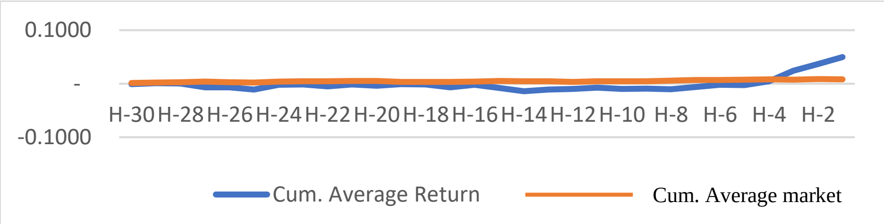

Figure 2. Cumulative Average Abnormal Return 30 Days Pre-Corporate Action Right Issue

Stockholders have responded to the Pre-emptive Rights policy without significant bias. Market conditions have shown a downward trend from H-30 to H-6, however, a positive shift began to occur from H-5 due to a cumulative increase until H-1. The average return for the 30 days before the corporate action right issue and the Cumulative Average Abnormal Return for the same period can be calculated. The average return for the 30 days before the corporate action right issue and the Cumulative Average Abnormal Return for the same period can be calculated. Technical term abbreviations will be explained upon their first usage. This abnormal return test begins by calculating the stock returns using the closing price data for each stock, then calculating the expected return to find out how fair the market return is, and as a comparison, whether the return received is in line with the expected return standard.

Table 1. T-test 30 days before the Right Issue decision

days	AAR	KSE	t-value	t-table	P-Value
H-30	-0,00189	0,002866	- 0,660924	1,6973	Not Significant
H-29	0,00061	0,003934	0,154502	1,6973	Not Significant
H-28	-0,00129	0,003594	- 0,358490	1,6973	Not Significant
H-27	-0,00774	0,003328	- 2,324714	1,6973	significant
H-26	0,00033	0,003677	0,091043	1,6973	Not Significant
H-25	-0,00333	0,003595	- 0,927252	1,6973	Not Significant
H-24	0,00757	0,004773	1,585425	1,6973	Not Significant
H-23	-0,00019	0,004455	- 0,042938	1,6973	Not Significant
H-22	-0,00381	0,004294	- 0,887756	1,6973	Not Significant
H-21	0,00277	0,003998	0,693277	1,6973	Not Significant
H-20	-0,00173	0,002859	- 0,605762	1,6973	Not Significant
H-19	0,00416	0,005332	0,780860	1,6973	Not Significant
H-18	0,00011	0,005809	0,019666	1,6973	Not Significant
H-17	-0,00541	0,003876	- 1,395572	1,6973	Not Significant
H-16	0,00398	0,004041	0,985239	1,6973	Not Significant

days	AAR	KSE	t-value	t-table	P-Value
H-15	0,00696	0,004161	1,673113	1,6973	Not Significant
H-14	-0,00556	0,003647	- 1,523555	1,6973	Not Significant
H-13	0,00336	0,004635	0,725598	1,6973	Not Significant
H-12	-0,00123	0,004065	- 0,302727	1,6973	Not Significant
H-11	0,00573	0,005531	1,036114	1,6973	Not Significant
H-10	-0,00327	0,003222	- 1,016168	1,6973	Not Significant
H-9	0,00114	0,003433	0,332504	1,6973	Not Significant
H-8	-0,00258	0,002419	- 1,064972	1,6973	Not Significant
H-7	0,00295	0,003596	0,820414	1,6973	Not Significant
H-6	0,00431	0,003965	1,087945	1,6973	Not Significant
H-5	-0,00110	0,003448	- 0,318033	1,6973	Not Significant
H-4	0,00620	0,005576	1,111215	1,6973	Not Significant
H-3	0,02054	0,006151	3,339110	1,6973	significant
H-2	0,01122	0,006851	1,638076	1,6973	Not Significant
H-1	0,01349	0,006722	2,006516	1,6973	significant

Table 1 indicates that during the period spanning H-30 to H-28, the market did not respond to the matter of Pre-emptive Rights that will be determined at the stockholder meeting. However, on H-27, there was a noteworthy negative abnormal return value due to the negative t value. Additionally, the market did not react from H-26 to H-4. On H-3 and H-1, there was a significant positive abnormal return value since the t count exceeded the t table, thus, it is deemed significant. The Rights Issue on H-27, H-3, and H-1 is influenced by private information and institutional ownership.

Table 2. Impact of Private Information and Institutional Ownership on Abnormal Return

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	,176	,074		2,388	,019
	Institusi	-,163	,089	-,171	-1,825	,071
	PriInf	-,001	,010	-,009	-,098	,922

a. Dependent Variable: H27

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	,100	,046		2,152	,034
	Institusi	-,083	,056	-,139	-1,479	,142
	PriInf	,001	,006	,015	,155	,877

a. Dependent Variable: H3

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	,043	,022		1,958	,053
	Institusi	-,043	,026	-,152	-1,612	,110
	PriInf	,000	,003	,006	,068	,946

a. Dependent Variable: H1

Table 2 shows that Private Information in H-1 does not significantly affect abnormal returns. The H-1 significance value on private information is 0.068. Before the firm needs funds for operations, issuing new stocks (right issue) through Pre-emptive Rights is usually discussed internally. It is important to evaluate several funding strategies before making funding decisions. The firm has released information about newly issued stocks, but the exact amount and price have not been determined yet. The careful evaluation process requires sufficient time. Investors should keep this information when deciding on additional stocks. The decision on the amount and price of new stocks may be a signal for investors to reassess their investments. The price of preemptive rights is always set below the market price of the firm's stocks. The number of stocks that stockholders purchase is then used as a reference point in determining the value of new post-emptive rights. Institutional Ownership has no significant impact on abnormal returns at H-1.

Table 4 Effect of Private Information and Institutional Ownership on ACAR

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	,049	,047		1,034	,304
	Institusi	-,004	,006	-,060	-,628	,531
	PriInf	-,047	,057	-,077	-,816	,416

a. Dependent Variable: ACAR30

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	,035	,022		1,566	,120
	Institusi	,000	,003	,004	,046	,964
	PriInf	-,027	,027	-,094	-,996	,321

a. Dependent Variable: ACAR5

Table 4 shows the impact of private information on the average cumulative abnormal return (ACAR) on H-5, demonstrating that the results are insignificant. Therefore, institutional ownership does not significantly affect ACAR. This variable often contains confidential information from within the firm.

CONCLUSION

Based on statistical tests, it can be concluded that the market did not react to the issue of pre-emptive rights from H-30 to H-28, which will be decided at the GMS. A significant negative abnormal return value was observed on H-27 because of the negative t value. The market once again did not react from H-26 to H-4. There were significant positive abnormal return values observed on H-3 and H-1 because the t count was greater than the t table, which implies positive significance. The pre-emptive rights issue on H-27, H-3, and H-1 appears to be affected by private information and institutional ownership.The study examined the impact of private information on abnormal returns. The findings indicate a significant negative effect of private information on abnormal return for H-27. However, for H-3, private information has no significant effect on abnormal returns Additionally, the relationship between H-1 private information and abnormal return is not significant. This study identifies the potential impact of private information on new stock offerings through rights issues. The offering of new stocks (right issue) through right issue is often discussed within the firm before requiring funds for operations. Before making funding decisions, several funding strategies should be considered. The results of the test indicate that the data for H-27, H-3, and H-1. Therefore, it can be concluded that Institutional Ownership had no significant effect on abnormal returns during those days. Therefore, private information does not significantly affect ACAR. The issue of Pre-emptive Rights invalidates some obtained information. This indicates that institutional ownership does not exert a significant impact on ACAR. It is worth noting that this variable often serves as a source of confidential information from a firm's internal parties.

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