

RESPONSE INVESTOR TO THE SPECIFIC CAPITAL EXPENDITURE: CASE STUDIES IN THE BANKING SECTOR

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RESPONSE INVESTOR TO THE SPECIFIC CAPITAL EXPENDITURE: CASE STUDIES IN THE BANKING SECTOR

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JUNIARTI

Department of Accountancy
Petra Christian University
Surabaya, Indonesia
yunie@petra.ac.id

AGUS ARIANTO TOLY

Department of Accountancy
Petra Christian University
Surabaya, Indonesia
agustoly@petra.ac.id

Abstract: The topic of investor response to capital expenditure is still quite limited, especially those related to the types of capital expenditure. This study aims to test whether the market responds differently to each type of capital expenditure announcement. To get better results, this study uses a specific industry, namely banking which in previous studies was often not included as a sample for reasons of the specificity of the report form. All banks that went public on the Indonesia Stock Exchange and met the research criteria were selected as samples. There are 39 eligible companies, so in total during the 2015-2019 period, there are 169 observations.

The findings of this study are (1) on average, the share return of companies that make capital expenditure announcements, whether asset expenditure, mergers/acquisitions and opening new branches, is higher than the control sample, (2) the market responds positively to acquisitions and mergers, while assets expenditure is not significant, and the opening of a new branch has received a negative response. This research contributes to broadening the generalizability of the results by conducting research in specific industries where the results are in line with results in other sectors. One of the important managerial implications in this study is the manager's caution in choosing capital expenditure activities, so that the signal for value creation from these activities is captured by the market.

Keywords: specific capital expenditure, response investor, share return

1 Introduction

The company's actions to make capital expenditures are interesting readings for investors. A number of previous studies have documented evidence that companies have succeeded in sending positive signals to investors through their capital expenditures. During the COVID-19 period, many banks in Indonesia have achieved success through mergers, acquisitions or opening new factories. Bank Artho, one of the conventional banks, has metamorphosed into a digital bank through the merger. This change was immediately followed by the soaring stock market price of Bank Artho which later changed its name to Bank Jago. Although mergers and acquisitions are one of the normal business activities, these actions have received tremendous response from the market. Mergers, acquisitions, opening new branches or factories are ways for management to build a business empire. According to agency theory, management prefers to use idle funds to grow the company rather than to be distributed to investors (Jensen, 1986; Harford, 1999).

A series of previous empirical studies have documented that the market responds positively to capital expenditure activities in various forms, one of which is through mergers and acquisitions. Companies with low performance actually give a surprise to the market when carrying out acquisition activities, where the post-merger financial and stock market

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performance increases significantly (Zeng and Huang, 2018). Announcements of strategic investments made by the company are proven to contain positive information signals, and are perceived by investors as value enhancing decisions (Kaur & Kaur, 2019).

Studies conducted by Woolridge (1998) and Woolridge and Snow (1990) found that market reactions differ for each type of strategic investment announcement. They identify that there are differences in abnormal returns for each type of investment decision. Capital expenditure in various forms of investment activity is seen as a profitable decision by the market, the market rewards the company's long-term decisions (McConnell & Muscarella, 1980; Chan et al., 1990; Jung et al., 1996; Jones et al., 2004). In addition, strategic investment decisions, although in the short term reduce financial performance, but contribute positively to long-term financial performance (Moser et al., 2021).

In various previous studies, generally the financial sector is often not included in the sample, because of the specific financial statements, so it is not widely known how investors respond to investment decisions in this sector. Kaur & Kaur (2019) in their study found that company-specific characteristics gave different market reactions to strategic investment decisions. Specific characteristics of the industry are likely to give a different market response than those in sectors other than banking. Therefore, this research will be conducted exclusively in the banking industry to expand the existing empirical evidence. In contrast to many previous studies that have not specifically distinguished the types of capital expenditure. This research will sort out the types of capital expenditures carried out whether in the form of opening a new factory, merger or acquisition. These three types of capital expenditure were chosen, in accordance with the phenomenon that is often found in Indonesia, where the three types of capital expenditure are the favorites of managers.

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2 Literature Review and Hypothesis Development

2.1 Efficient Market Hypothesis

Efficient capital market theory provides an explanation of investor response studies to information provided by companies either directly through the publication of financial performance or indirectly through announcements of corporate actions. Efficient pricing of the stock market is one of the most researched topics (Woolridge & Snow, 1990). Very fast developments in empirical studies of capital markets support that securities price are efficiently informed of all published information (Brealey & Myers, 1988). This phenomenon is then widely tested by assessing the market reaction to corporate action. In an efficient market condition, the announcement of strategic decisions related to capital expenditures will be quickly responded by the market, there will be an adjustment of market capitalization in accordance with the expected net present value of the announced capital expenditure decisions (Fama 1970, 1990). Strategic decisions will have an impact on the long-term performance of a company (Jones et al., 2014). Investors in the capital market will react to the announcement of capital expenditure decisions by reassessing the market value of the company that made the announcement (McConnell & Muscarella, 1985).

In their study, McConnell & Muscarella (1985) confirms that an unexpected increase in capital expenditure will increase the market price of ordinary shares and vice versa, an announcement of an unexpected decrease in capital expenditure will be anticipated by a decrease in the market price of ordinary shares. The market responds positively or negatively to announcements of increases and decreases in capital expenditures regardless of the type of capital expenditures. When managers need additional investment to fund projects in the future, this will provide better information about the projected future returns that potential investors will receive (Trueman 1986). In terms of mergers and acquisitions, it is found that small companies have a greater abnormal announcement return than relatively larger companies.

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2.2 Signaling Theory

Signaling theory is also widely used to explain how the market reacts to signals sent by management through a series of corporate actions. The more precisely the market responds to the signals given by management, the better the quality of the signals. Superior management provides a quality signal to the market which is not easily imitated by lower quality managers (Spence, 1973). The existence of information disparities between management and outsiders requires transferring internal information to external parties to narrow the difference (Spence 2002, Stiglitz, 2002). Through certain corporate actions whether mergers, acquisitions, opening of new factories, dividend distribution and so on, management is sending signals of a promising future to investors and other stakeholders (Engers, 1987).

In the signaling perspective, the company's actions in mergers, acquisitions, opening of new factories and other corporate actions aim to send a signal to investors that there is a potential return that will be sustainable in the future (Diamond, 1989). In his research, Trueman (1986) posits that the level of investment will be able to more fully disclose information, providing a stronger signal level for certain information. The market reaction to the announcement of capital expenditure because the announcement contains a signal of current earnings from projects that are ready to operate (McConnel & Muscarella, 1985)..

2.3 Prior Empirical Studies

Studies on market response to corporate action have been initiated by a number of previous studies. One of the phenomenal studies related to corporate action and market response is the research conducted by McConnell and Muscarella (1985). The study used two sample groups, industrial companies and public utility companies. The study was conducted on 547 announcements made by 247 industrial companies and 127 announcements made by 72 different public utility companies. With the exception of the results for public utility companies, in general they find that based on the market value maximization hypothesis and the traditional model of corporate valuation, it shows that an unexpected increase in capital expenditure results in an increase in stock market prices and vice versa. In his research Trueman (1986) considers the level of investment, where in his research findings indicate that the amount or amount of investment provides perfect information regarding the true value of the company.

Woolridge & Snow (1990) conducted more specific research on the announcement of strategic investment decisions which include joint ventures, R&D projects, product/market diversification and capital expenditures. The research findings support that strategic investment decisions increase cumulative abnormal returns. Tests per type of strategic decision show congruent results that the market responds positively. What is interesting is that the investor's response is significant only at t-1 and t=0, meaning that the response is strong only at the time of the announcement and the day before the announcement, after that, returns move back to normal. In contrast to previous studies, which tested capital expenditure with future earnings, Kerstein & Kim (1995), tested incremental capital expenditure and whether it was caught in current earnings which resulted in the market responding positively. The results showed that after controlling for concurrent earning information and the size of the previous period's information disclosure, they found that incremental capital provides excess returns. Chung et al. (1998) added the investment opportunity quality variable to provide additional explanations for the results of previous studies, where the increase/decrease in capital expenditure had a positive/negative effect on market response. The results of Chung et al's (1998) research support the prediction that investor response to capital expenditure information depends on the quality of investment opportunities. This study was then followed by Jones et al. (2004) who found that investment opportunity is an important variable in the relationship between capital expenditure announcement and market response.

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Burton et al. (1999) found that there are two important things that have not received attention by previous studies, namely the ability of investment projects to immediately generate cash or not, secondly whether investment decisions are made by individual companies or joint ventures. The results show that investment projects carried out by joint ventures surprise the market and increase market expectations of the prospects of participating companies, while investment projects carried out by individual firms have an impact on abnormal returns. Among the investment projects carried out by individuals that immediately generate cash, the market responded positively. Brailsford & Yeoh (2004) found that company-specific factors such as growth opportunities, cash flow conditions and their interactions will affect the market response to new capital expenditure announcements. The company's focus, whether single segment or multiple segments, turns out to be an important characteristic that needs to be considered. Announcements of new capital expenditures made by single-segment companies received a stronger positive response compared to those made by multi-segment companies (Chen, 2006).

Several subsequent studies were conducted on a longer research period and a wider sample (Akbar et al., 2008). The results of the study confirm the findings of previous studies as conducted by Bhanna (2008). Luo (2016) uses a capex model derived from an accounting-based estimation model and a capex guideline factor which is predicted to reduce information asymmetry and increase market response to investment decisions. The Kaur & Kaur (2019) research is quite unique because it provides new evidence of market response to strategic investment decisions in a developing country, India, considering that this topic is still very rarely studied in the context of developing countries.

2. Hypothesis Development

Capital expenditure in various forms of strategic investment decisions is a significant commitment of resources to achieve future returns (Woolridge & Snow 1990). This information provides an important signal to the market of potential future cash inflows. Various studies document that announcements of corporate actions to invest their resources in specific capital expenditures are captured as opportunities for increasing value in the future (Kaur & Kaur, 2019).

The research hypothesis is based on two important theories, namely efficient capital markets and signaling theory. Capital expenditure in various forms has different capacities to create value for investors. Based on the description above, the following hypothesis is compiled:

Hypothesis 1: The market responds to asset release announcements

Hypothesis 2: The market responds to announcements of acquisitions and mergers

Hypothesis 3: The market responds to the announcement of the opening of a new branch Office.

3. Research method

3.1 Data

This research was conducted specifically in the banking sector, which is one sector that is often avoided to be studied due to the specificity of the financial statements of this sector. All banks that went public on the Indonesia Stock Exchange during the study period and announced mergers, acquisitions or new branch openings were sampled for this study. There are 46 banks that have been registered with IDX, of which 39 banks have been selected that meet the requirements, during the 2015-2020 period. Some banks do not have complete data or have not been listed for at least the last 5 years, so the number of samples that meet the criteria is 169 observations

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3.2 Analysis Model

Investor response in this study was measured by changes in stock prices during the announcement period. We used an 11-day event window, namely 5 days before, the day of the announcement, and 5 days after the announcement date. Following a number of previous research recommendations that showed the need to control the analytical model with company-specific characteristics, this study includes the company's financial performance, both accrual-based such as EPS and ROA as well as cash-based, starting from cash flows from operating (CFO), cash flows from investing (CFI), and cash flow from financing (CFF). In addition, the analytical model also includes growth opportunities and risks, each of which is measured by incremental sales and leverage, considering that these two variables have also been shown to significantly influence the market response to the announcement of new capital expenditures (Brailsford & Yeoh, 2004; Chung et al., 2004; Jones et al., 2004).

$$SRETURN_i = \alpha + \beta_1 D1_i + \beta_2 D2_i + \beta_3 ROA_t + \beta_4 EPS + \beta_5 CFI_t + \beta_6 CFF_t + \beta_7 LEV_t + \beta_8 LOGSALE_t + \varepsilon_{it} \quad (1)$$

Notes:

SRETURN = Stock return

D1, D2= The dummy variable representing each type of capital expenditure decision announcement is D1=1, if the company announces a merger, D2=1, if the company announces the opening of a new branch office, while asset expenditure is captured by the intercept.

ROA = return on company assets i

EPS = earnings per share of company i

CFO = cash flows from operating company i

CFI = cash flows from investing company i

CFF = cash flow from financing company i

DER = company leverage i

LOGSALE = logarithm of change in total sales divided by total assets, company i

3.3 Operationalization of Variables

The operationalization of the variables used in this study is described below.

1. Stock Return (SRETURN) is a proxy for market response, calculated from the average change in stock market prices within the 11-day event window.
2. Capital expenditure uses proxies, namely announcements of mergers, acquisitions or new office openings, D1=1, if the company announces a merger, D2=1, if the company announces the opening of a new branch office, while asset expenditure is captured by intercept.
3. Return on Assets (ROA) is a measure of financial performance, which in this case is calculated by dividing net income by total assets.
4. Earning per Share (EPS) is a measurement of financial performance, namely net income divided by the number of ordinary shares in circulation.
5. Cash flow from operations (CFO), Cash flow from Investing (CFI) and Cash flow from Financing (CFF) are cash-based performance measures, obtained from operating cash flows, investment cash flows and financial cash flows contained in the cash flow statement. company.
6. Debt to Equity ratio (DER) is a measure of a company's risk, obtained from total liabilities divided by total assets.

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7. Sales log is a proxy for growth opportunity, measured by the logarithm of incremental sales divided by total assets

4. Data Analysis

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The descriptive statistics are presented in Table 1 and the correlations between the research variables are presented in Table 2. Based on the data in Table 2. It shows that all variables related to the types of capital expenditure, namely ASSETEX, ACQUI, NEWPLANT have a significant correlation with SRETURN, at the level of significance. 5%. The accrual-based financial performance variables, namely ROA and EPS, both have a significant correlation with SRETURN, while for cash-based financial performance only CFF is correlated with SRETURN. Variables related to company-specific characteristics, namely, DER and LOGSALES both have a strong correlation with SRETURN, at significance levels of 5% and 10%.

Table 1. Descriptive Statistic

	N	Mean	Minimum	Maximum	Std. Deviation
ROA	169	0,006	-0,110	0,090	0,022
EPS	169	75,843	-498,82	1159,430	181,126
CFO	169	120,049	-2670,03	5990,280	744,384
CFI	169	-86,550	-3836,52	2652,390	555,973
CFF	169	28,626	-538,990	797,010	155,717
DER	169	423,983	0,000	6389,180	930,763
LOGALES	164	12,123	10,500	14,050	0,837

Table 2. Correlation

	1	2	3	4	5	6	7	8	9	10	11
1.SRETURN	1										
2.ASSETEX	,25(**)	1									
3.ACQUI	,26(**)	,98(**)	1								
4.NEWPLANT	,28(**)	,45(**)	,43(**)	1							
5.ROA	,26(**)	0,09	0,09	0,09	1						
6.EPS	,88(**)	,29(**)	,31(**)	,30(**)	,48(**)	1					
7.CFO	-0,02	-0,03	-0,01	-0,06	0,03	0,02	1				
8.CFI	-0,09	0,01	0,02	0,02	-0,03	-0,04	-0,1	1			
9.CFF	-,20(**)	-0,06	-0,11	-0,10	-0,15	-,26(**)	-0,10	0,02	1		
10.DER	,19(*)	,19(*)	,21(**)	,19(*)	0,14	,36(**)	-0,03	0,02	,45(**)	1	
11.LOGSALES	,50(**)	,34(**)	,36(**)	,37(**)	,44(**)	,63(**)	0,00	0,01	-0,08	,54(**)	1

** Correlation is significant at the 0.01 level (2 tailed).

*Correlation is significant at the 0.05 level (2-tailed).

4.1 Market response analysis on each type of capital expenditure announcement

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This study specifies the announcement of capital expenditure in accordance with the main activities carried out or functions, so that the underlying value creation characteristics can be evaluated (Jones et al., 2014). The analysis of each capital expenditure case shows that there are differences in the average share return of companies that announce capital expenditures in the form of asset expenditures for investment, acquisitions and mergers and the opening of new branches. Companies that make capital expenditure announcements have a higher average share return than control companies. Each is significant at the 5% level (Table 3)

Management needs to consider the implications of each investment decision on future financial projections. If the market understands this implication, then the market will see a

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growth opportunity and investment decisions will be valued higher than the investment can generate (Dixit & Pindyck, 1995). The higher average share return in companies that spend assets for investment, acquisition or opening of new offices implies a signal of growth opportunities on capital expenditures captured by the market (Engers, 1987). The market perceives that the capital expenditures made by the company will produce a positive net present value, so that the announcement of capital expenditures increases the share price (Jianchuan, 2016).

Table 3. Share return per type of Capital Expenditure

Type of Capital Expenditure	Cases	Mean	t-test	Sig
ASSETEX				
Yes	38	3386,607	2,131	0,039 **
no	131	1011,523		
ACQUI				
yes	37	3391,651	2,066	0,046 **
no	132	1028,102		
NEWPLANT				
yes	43	3365,281	2.046	0,046 **
no	126	924,552		

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4.2 Regression analysis

Table 4. presents a regression model to test investor responses around the announcement date of capital expenditures. Each type of capital expenditure has a different effect on the return, according to the characteristics and signals captured by the market for capital expenditure events. The regression model will help determine the type of capital expenditure that provides a higher return than others. Following Chen (2006) and Bhana (2008), the type of capital expenditure in this study is represented by a dummy variable.

Of the three types of capital expenditure announcements studied, asset expenditure has no effect, because the intercept of this model is negative and insignificant. The market sees that the announcement of asset expenditures alone is not very specific to assess how the company's prospects will be in the future (Bhana, 2008). For acquisitions/mergers, consistent with a number of previous studies, the company's actions to make acquisitions and mergers provide a positive signal to the market and help the market to project future returns. The D1-ACQUI coefficient is positive and significant at the 10% level, this result supports H2. Empirical evidence shows that mergers and acquisitions result in the creation of wealth for shareholders (Rajan et al., 2013; Kohli and Mann (2011), Gubbi et al. (2010).

Furthermore, for the announcement of capital expenditure in the form of opening a new branch, the response was negative and significant. In the digital era and the rapid development of information technology, the opening of new branches implies management's insensitivity to the existing situation. This action causes counter-productivity. Anxiety over inefficiency that will potentially interfere with the company's ability to create value for shareholders. Management needs to be careful, because the market is closely watching the potential value creation of every capital expenditure action.

Table 4. Regression Analysis

	Standardized Coefficients	t	Sig.
(Constant)		-1,517	0,131
D1-ACQUI	0,326	1,74	0,084 *
D2-NEWPLANT	-0,318	-1,716	0,088 *

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ROA	-0,221	-6,097	0,000	***
EPS	1,098	24,39	0,000	***
CFO	-0,044	-1,429	0,155	
CFI	-0,055	-1,796	0,074	*
CFF	0,199	4,418	0,000	***
DER	-0,311	-6,255	0,000	***
LOGSALES	0,083	1,791	0,075	*
Adj R-square				0,849
F				103,052
Sig				0,000

This study involves a number of control variables, namely financial performance. In the efficient capital market hypothesis, the market responds to all published information, including the company's financial performance. All control variables related to financial performance have an effect on stock returns, except for CFO, because on average the company has a negative CFO in the study period⁹.

DER represents risk and has been shown to have a significant negative effect on market response. Although on the other hand DER also helps shareholders monitor management, the market agrees that a high DER will interfere with the company's ability to provide adequate returns for investors. LOGSALES describes the company's growth opportunities in the future, growth indicates sustainability. Companies that have growth are seen as more appropriate to make capital expenditures, because the success of investment projects is also determined by the company's capacity to grow (Woolridge & Snow, 1990; Chen, 2006; Bhana, 2008).

5 Conclusion

This study follows up on previous research through a more specific test of capital expenditure, considering that each type of capital expenditure has a different value enhancing capacity. Consistent with a number of previous studies, this study proves that the types of capital expenditure are responded to differently. Acquisitions and mergers are the most dominant types of capital expenditure responded by the market. The market belief that acquisitions and mergers can create wealth for shareholders is stronger than other forms of capital expenditure.

Capital expenditure that is not specific, such as spending on assets alone, does not cause a surprise to the market, because the market needs a specific explanation of the form of capital expenditure that is carried out so that it can evaluate it proportionally. The opening of a new office, which is another form of capital expenditure, received a negative response from the market. In a state of disruption due to radical technological developments, opening new branches is considered a counter-productive action.

Risks and growth opportunities, both of which have been shown to have a significant negative and significant positive effect, these findings need to be followed up in future studies, because in the current study these two variables were only partially tested. The possibility that the two variables moderate the investor's response to capital expenditure can be proven in future research. Overall, the results of this study contribute to expanding the results of previous research on investor responses to capital expenditure in a specific banking industry.

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