E-PROCEEDINGS

WORLD FINANCE CONFERENCE

BUENOS AIRES, JULY 22-24, 2015

ARGENTINA

INDEX

Understanding Money and the Financial Crisis:The Central Bank’s Dilemma, the Inflation-Deflation Paradox and a New Interpretation of the Kondratieff Waves

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Abstract

The article tries to contribute to a new understanding of how money is created by commercial banks and to describe the dilemma, which after some time, every Central Bank within the fractional reserve banking system faces. This dilemma provides an explication for the politics of “cheap money” that has been applied by Central Banks of almost every industrialized economy during the last years, despite the fact that the money supply has reached unprecedented levels. This context is then used to describe what might be called the "Inflation-Deflation Paradox" and to offer a new interpretation of the long economic cycles, the so-called Kondratieff waves.

The Potential Demand for Microcredit in Argentina

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Abstract

This paper estimates and characterizes the profiles of the potential demand for microcredit in Argentina according to a number of socioeconomic and demographic attributes. Our estimates are based on a survey from 5682 stratified households in Argentina for 2010. We estimate a potential demand of about 966.573 to 1.636.366 potential consumers depending on the poverty line assumptions used. These potential consumers are mostly employees (followed by self-employed) and symmetrically divided into formal and informal, almost half of them within the range of 30 to 49 years, over 60% male, 52% without access to banking services and primarily located in the Southern and Western Greater Buenos Aires and Córdoba.

The effect of Dividend Policy, Company Size and Beta Coefficient on Stock Return

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Abstract

There are numerous works in the finance literature which emphasize on expected returns and risks for future investments. Those works are based on the idea of the researcher that the factors that he is using would determine the relation between expected return and risk. In this thesis we chose stocks as an investment tool. Also, we preferred beta coefficient, dividend policy and firm size as factors which may affect our investment. To describe the effect of those factors on our investment, we chose stocks which were performing in the Istanbul stock exchange industrial index between January 2000 and September 2013. We then calculated the return of those stocks within January 2002 - June 2013. In order to show the effect of those factors we built seven main portfolios. These portfolios are based on the firms that we selected for our research purpose. We divided those firms according to each factor: for beta coefficient we divided those firms into two portfolios (the firms with a beta coefficient below 1 and the firms with a beta coefficient above 1); we divided those firms into two groups according to their dividend policy (dividend-paying companies and non-dividend-paying companies); lastly we divided those firms into three portfolios in accordance with their size (we divided firms as small, medium and big). In our research we also tried to show the effect of dual combination of the factors that we have chosen. In order to show the effect of dual combination of those factors we created 16 sub portfolios. We monthly calculated the return of those portfolios and we also yearly reconstructed them according to each factor. In order to determine the real effect of those factors we calculated mean, cumulative return, standard deviation, and we used risk adjusted performance measures of each portfolio and compared them to each other.

A Composite Indicator of Systemic Stress (CISS) for Colombia

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Abstract

The most recent global financial crisis (2008-2009)highlighted the importance of systemic risk and promoted academic interest to develop a wide set of warning indicators, which are mechanisms to identify systemically important institutions and global systemic risk indexes. Using the methodology proposed by Holló et al. (2012),along with some considerations from Hakkio & Keeton (2009),this document comprises a Composite Indicator of Systemic Stress (CISS) for Colombia. The index takes into account several dimensions related to financial markets (credit institutions, housing market,external sector, money market and local bond market) and is constructed using portfolio theory,considering the contagion among dimensions. Results suggest the peak of the global financial crisis(September 2008) as the most important episode of systemic risk in Colombia between 2000-2014. Additionally, real activity seems to be adversely affected by an unexpected increase of the systemic risk index.

Implied Convexity In VIX Futures and Its Properties

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Abstract

We examine the properties of the convexity adjustment needed to value VIX futures prices. Rather than proposing another VIX futures pricing model, we develop the "implied convexity" for VIX futures. The implied convexity extracts the missing convexity adjustment component needed between the observed VIX futures price and the forward-starting variance swap rate. We then study the properties of this convexity adjustment, both as a time series and with respect to various market dynamics. We find that implied convexity often violates no-arbitrage conditions since it is frequently negative, and that implied convexity is strongly statistically related to market volatility. We also investigate the ability of implied convexity to predict realized VIX futures price variances, finding that it underestimates the realized VIX futures variance 71.39% of the time.

Lenders on the Storm of Wholesale Funding shocks: Saved by the Central Bank?

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Abstract

We provide empirical evidence on banks' responses to shocks in wholesale funding, using data of 181 euro area banks over the period August 2007 to June 2013. Banks' adjustments of loan volumes and lending rates in responses to funding liquidity shocks are analysed in a panel VAR framework. The results show that shocks in the securities and interbank markets have significant effects on loan rates and credit supply, particularly of banks in stressed countries. Central bank liquidity has mitigated this effect. Lending to non-financial corporations is more sensitive to wholesale funding shocks than lending to households. Moreover, bank characteristics matter for monetary transmission: loan growth of large banks that are typically more dependent on wholesale funding and of banks with greater exposures to government bonds shows relatively stronger responses to wholesale funding shocks.

The Influence of Market States on Investment Strategies: Evidence from Indian Stock Market

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Abstract

Abstract This study contributes to the growing literature on momentum and overreaction effect by investigating them within the framework of Indian stock market. Based on the most adopted methodology that employs monthly data, the empirical results confirm the existence of momentum and long term overreaction effect in the Indian stock market. The overall results from the study are consistent with DeBondt and Thaler (1985) and Jegadeesh and Titman (1993). In addition the paper tested the various momentum and contrarian strategies under different market states. The results indicate a relationship between the market state and momentum. Profitable strategies were observed only following an up markets. On the contrary, long term contrarian strategies can be exploited majorly by Indian investors in the down market. The evidence provides partial support to various behavioural models to explain these effects in Indian stock market. However, there exists a need to develop a single behavioural model that could explain both the anomalies in emerging market like India.

Financial Constraints, R&D and the Value of Cash Holdings

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Abstract

Existing studies document that cash holdings are more valuable for financially constrained firms than for financially unconstrained firms. We investigate whether the relation between financial constraints and the value of corporate cash holdings varies across firms with different engagement in research and development activity. Among firms with R&D investment, the marginal value of cash is significantly higher for financially constrained firms than unconstrained ones, whereas this difference is not significant among firms without R&D investment. Our findings are robust to alternative measures of financial constraints, alternative methods to define R&D intensity, and have evolved over time. Our study extends the cash literature by showing that the value of cash holdings is affected by both financial constraints and the nature of investment jointly.

Determinants of Implied Volatility Slope of S&P 500 Options

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Abstract

We examine the possible determinants of the observed implied volatility skew of S&P 500 index options. We document that order flow toxicity measured by Volume-Synchronized Probability of Informed Trading (VPIN, Easley et al., 2012) is an important determinant of the slope of the volatility skew besides transactions costs and net buying pressure. We further analyze the relation at macroeconomic announcements and find that the effect of uncertainty resolution dominates when there is an announcement and when the surprise component of the announcement is higher. Model-free risk-neutral skewness measure which is highly correlated with slope is also significantly associated with VPIN.

Conditional Correlation Modelling via LDL Decomposition and Kalman Recursions

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Abstract

An innovative approach to modelling conditional covariances and correlations useful e.g. in the multivariate GARCH context is proposed. The introduced two stage method is based on the LDLdecomposition of the conditional covariance matrix, state space modelling and the associated Kalman recursions. Jointly, they deliver a dynamic orthogonal transformation of an observed process. Such a time-varying transformation shifts the original multivariate problem to a set of univariate ones which can be handled by standard methods available for conditional variance modelling. The suggested technique is compared with other common methods in an extensive Monte Carlo study. It is also investigated by two examples using empirical datasets: for (1) S&P index and bond futures and for (2) EU currencies. It seems that this numerically effective approach is at least competitive with others.

The Learning Process of Stock Trading Decisons: An EEG Analysis

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Abstract

E cient Market Hypotheses is the most controversial theory in nance and economics and assumes that investors are rational and maximizing their profits following theoretical rules and disregarding past experience to guide future decisions. Neuroscience, however, show that individuals learn to use di erent pieces of knowledge to think and make decisions but, until the moment, no investigation analyzed what happens in terms of learning process when people make nancial decisions. In this investigation we use EEG technology to map brain activity during a stock trading simulation performed in two di erent market conditions: a market that, on average, is growing and a market with high volatility. The results, and the brain activation maps created with EEG information, show that when volunters capture a certain investment strategy in the rst market that is sucessfull during several decisions they kept using these strategies for then rest of the experiment, even when they change to the reverse market. The results are among the rst to to show the human learning process of nancial decison making.

Loan Loss Accounting Rules and Bank Lending over the Cycle: Evidence from a Global Sample

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This study contributes to the ongoing debate on the procyclicality of loan loss provisions and its potential impact on bank lending by analyzing empirically how countries' loan loss accounting rules affect banks' lending behavior over the business cycle. For this purpose, we collect detailed information on local GAAP provisioning rules in a large number of countries across the globe and develop alternative indices that reflect how far banks are enabled to take a forward-looking approach in the assessment of their credit risk reserve. Consistent with the capital crunch hypothesis, we find banks' lending behavior to be more procyclical if they are subject to more backward-looking loan loss accounting rules.

A Regional Repo Market Initiative for Global Financial Stability

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Abstract

The prevailing international monetary system suffers from a shortage of good collateral for nonbank secured lending. Given that the global financial crisis was mainly triggered by the collapse of the collateral pool for dealer-based credit intermediation, there is a need for reforms to prevent it from happening again. This would be possible with a better use of U.S.Treasuries that are kept in silos and a broader recognition of an emerging market sovereign collateral pool. The inclusion of new collateral into the existing nonbank credit intermediation facilities of core countries would be expected to stabilize global capital flows and improve financial stability. The market-driven, risk-mitigating regional repo market initiative would also bring balance to an increasingly market-driven financial ecosystem and mitigate the global shortage of safe assets. Given the geopolitical constraints, developing a regional repo market in Asia is a viable option to take care of long-term rebalancing needs via market development as well as mitigating financial instabilities caused by increasingly collateral-based integration of the dollar-centric international monetary system.

Information Sharing Among Banks About Borrowers - What Type Would They Support?

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Abstract

Most financial economists assert that full information sharing among banks about borrowers would best serve the banks' and the borrowers' long-term interest. In reality, banks are not always keen on supporting full information sharing, and borrowers with good credit records will actually lose rather than gain under a full list as I shall demonstrate in the paper. I prove in the paper that in case the share of bad borrowers is small, fully rational banks would choose full information sharing, for they can charge higher interest rates to all borrowers and earn larger profits under a full list than with any other type of information sharing. But information sharing only about bad borrowers is the fully rational banks' dominant strategy if the fraction of bad borrowers is substantial. Myopic banks would opt for no information sharing if they serve a large fraction of bad customers in the current period, for they can dump their bad borrowers on competing banks in subsequent periods. Borrowers with good credit records, on the other hand, would prefer information sharing only about bad customers to full or to no information sharing, for they pay lower interest rates under a black list than with any other form of information sharing or with no information sharing.

The Relevance of International Spillovers and Asymmetric Effects in the Taylor Rule

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Abstract

Deviations of policy interest rates from the levels implied by the Taylor rule have been persistent before the financial crisis and increased especially after the turn of the century. Compared to the Taylor benchmark, policy rates were often too low. This paper provides evi-dence that both international spillovers, for instance international dependencies in the interest rate setting of central banks, and nonlinear reaction patterns can offer a more realistic specifica-tion of the Taylor rule in the main industrial countries. The inclusion of international spillovers and, even more, nonlinear dynamics improves the explanatory power of standard Taylor reac-tion functions. Deviations from Taylor rates tend to be smaller and their negative trend can be eliminated.

Is Collaborative Activism Effective ?

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Abstract

In this paper, we define collaborative activism (co-activism) as a set of independent activists that pursue the same objective and work together to influence corporate decisions. Using a hand-collected dataset from 1994 to 2013, we find that co-activism targets underperforming firms with less cash constraint, and is mostly nonhostile despite its initial attempt to control around 10% of stocks. Co-activism succeeds in roughly 80% of the cases through discussions with the management. The market responds favorably to co-activism around the date of filing, but market expectation tapers off, and eventually turns to negative over the subsequent years. Our evidence suggests that co-activism aims for short-term gains at the expense of long-term shareholder value, and pressures the companies to take myopic actions that are harmful in the long run.

Forecasting Excess Returns in the Housing Market with Local Cap Rates

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Abstract

We investigate the predictive power of rent-to-price ratios in an excess housing return equation. Relying on two large geo-coded databases related on the one hand to rents and on the other hand to selling prices in the Paris area from 1996 to 2007, we compile rent-to-prices ratios and price growth rates with individual modelings and localized imputation methods. Different sources of risk (price, rent or vacancy risk) are taken into account. We break down the contributions of this rent-to-price measurement on futures excess returns into different geographical scale contributions: from broad scale (city level) to small scale one (the land register unit level corresponding to a few building blocks). Comparing the forecasting power of rent-to-prices ratio at various spatial scales seems relevant when working on housing markets composed of illiquid assets with a large idiosyncratic component, but is not usually done by lack of data. The spatially-disaggregated forecasting equations are estimated with standard techniques for different forecast horizons (3 and 6 years). The time dimension of the sample being short, we analyse the impact of the small-sample bias on our estimates. We exhibit that rent-to-price ratios account for a substantial part of the forecasting error at medium term horizon, the largest share of it being captured by the smallest scale measure.

The European Twin Sovereign Debt and Banking Crises

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Abstract

Europe currently faces a severe economic and financial Great Crisis. It is often described as a sovereign debt crisis, but in fact it is really a sequence of interactions between sovereign problems and banking problems that caused a severe economic slowdown. It also caused a fragmentation of euro area financial markets. The explanation of the crisis focuses on the imbalances of European Monetary Union (EMU) countries balance-of-payments, where TARGET2 payment system became crucial, reflecting funding stress in the banking systems of crisis-hit countries. The decisions by European leaders to set up a banking union and the announcement, as well as adoption, of non-standard measures by the European Central Bank (ECB) greatly contributed to restoring confidence in euro area financial markets, improving market sentiment and reversing the earlier trend towards market fragmentation. Anyway, an expansion of European aggregate demand is needed to promote growth, and to this aim the role of Germany is crucial.

Investment Sensitivity to Stock Prices, Accounting Conservatism and Analyst Coverage

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Abstract

This study examines whether more analyst coverage mitigates the informational risk borne by small investors and improves the quality of reported accounting numbers. Using the investment-price sensitivity as a proxy for stock price informativeness and accounting conservatism as a proxy for the quality of reported earnings, we find evidence that analysts do not specialize in the production of firm-specific information and substitute for other corporate governance mechanisms. These main findings are robust to many aspects of our methodology.

Recovery Measures of Underfunded Pension Funds: Contribution Increase, No Indexation, or Pension Cut?

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Abstract

Using recovery plan data of 213 underfunded Dutch pension funds for the years 2011, 2012 and 2013, discrete choice models are estimated describing pension funds' choices between three recovery measures: contribution increase, no indexation, and pension cut. The estimation results suggest, firstly, that pension cuts are more likely when the funding ratio is very low, there is little time left for recovery, the pension fund is not a corporate pension fund, and its participants are still relatively young. Secondly, the results suggest that Dutch pension funds consider contribution increase first, no indexation second, and pension cuts only as a last resort.

The Role of Multilateral Development Banks in the Emergence and Development of Venture Capital

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Abstract

This study empirically evaluates the role of Multilateral Development Banks (MDBs) in the development of Venture Capital (VC) in Latin America and compares MDBs initiatives to similar public programs. The evidence suggests that MDBs contributed to the emergence of VC in the region and that funds supported by MDBs outperform funds supported by governments.

Analysis of CDS Correlation Pre- and During-European Debt Crisis Based on a New VAR-GARCH Model with SSAEPD Margins

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In this paper, in order to examine financial contagion phenomenon following the European debt crisis,we compare the correlation of CDS returns before and during European debt crisis with a New VAR-GARCH Model with SSAEPD Margins combined by Gaussian Copula . In this new model, a Gaussian Copula, GARCH-type volatility and non-Normal marginal error of SSAEPD in Zhu and Zinde-Walsh(2009) are used. Daily 5-year CDS returns of Credit Suisse Group and JP Morgan Chase &Co are studied. The sample period ranges from 1 January 2008 to 31 October 2014, which is divided into 2 two sub-periods :pre-crisis period and crisis-period .Method of MLE is employed to estimate the parameters and AIC is used to compare models. We apply the IRF for the mean equation and the VIRF for the conditional variance. We find out(1) the correlation of CDSs is much higher in crisis period,which means the linkage of two banks much increase after the shock of European debt crisis .It is consistent with the network theory of contagion. (2) The new model can capture the skewness, the fat tailness, the asymmetric tails of data, and has better in-sample fit. (3) Different from the model with Normal margins, in pre-crisis period, the new model has weaker IRFs for both shock from Credit Suisse Group and from JP Morgan Chase &Co ,and in crisis period, when the impulse is from Credit Suisse Group, the responses in the new model are more fluctant; when the impulse is from JP Morgan Chase &Co, the responses in the new model are lower.(4) The VIRFs of the new model are less fluctant. (5)Similar to the model with Normal margins, the RVC shows most variations of dependent variables are from its own histories.

Determinants of Funding Sources of Capital – A Sectored Approach in Brazil

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Abstract

The study of sources of capital financing of companies has been the focus for researchers empirically test theories of capital structure. Identify an optimal capital structure (if any !) is no easy task , due to the dependence of several dynamic variables; temporal and sectored. So the consensus seems distant, representing an interesting field of study. The objective of this work is to analyze the variables determining the capital structure of Brazilian non-financial companies within sectored scopes, in the period 1998-2013, using the Brazilian Database (Macrodados Sistemas Gerenciais). To design such revision of the most robust theories related to the capital structure are Pecking Order Theory (POT) and Trade-Off Theory (TOT). This work innovates in addressing the segmented view of business performance. It was found that 55.6% of the variation can be explained by variables included in the model . With the fixed effects model with dummy variables and White's robust correction, it appears that the various observations are statistically different across sectors. This finding reinforces the idea of the importance of the approach to the industry for the study of Capital Structure. Each sector has specific characteristics that lead to the composition of different sources of funding.

Euro at Risk: The Impact of Member Countries' Credit Risk on the Stability of the Common Currency

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Abstract

In this paper we propose a new indicator of currency stability. We make use of this new indicator and empirically investigate the impact of changes in sovereign risk of Eurozone member countries on the stability of the Euro. The stability of the Euro is proxied by decomposing Dollar-Euro exchange rate options into the moments of the risk-neutral distribution. Our stability measure can nicely separate periods of Dollar instability (the subprime crisis period) and Euro instability (the sovereign debt crisis period). In particular, we document that only during the sovereign debt crisis, changes in the creditworthiness of member countries with vulnerable fiscal positions have a significant impact on the stability of the common currency. Interestingly, however, the market perceives Greece not to be 'systemically relevant'.

Real Options Valuation Under Uncertainty

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Abstract

In this paper we develop a novel valuation model and methodology to value a pharmaceutical R&D project based on real options approach. The real options approach enables the possibility of optimally abandon the project before completion whenever the investment cost turns out to be larger than the expected net cash flow stream. On the other hand, the proposed model accounts for two different sources of uncertainty, those are technical and economic risk. This model incorporates a novel economic state vector where each economic state captures the interaction among different market and economic forces using Fourier series as the particular basis for the economic function space. In this sense, Fourier series are considered as an aggregate of forces playing a relevant role in the process evolution determining the cash flow structure and also allowing us to properly define an economic scenario where the project will be developed.

Dividends as a Signaling Device and the Disappearing Dividend Puzzle

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Abstract

In this paper we develop a generalization of the Baker and Wurgler (2012) signaling model where investors are loss-averse to dividend cuts. We apply our framework to study how a firm's characteristics and manager's incentives affect payout policy properties. In equilibrium firms with riskier earnings are less likely to pay dividends, however, those that pay, payout more. Similarly, firms whose managers have a higher share of stock options in their compensation package are less likely to pay positive dividends. There is a clientele effect. Investors' preferences and choices affect the payout policy and two otherwise identical firms can greatly differ in how they pay dividends. Finally, we relate our model's predictions to the disappearing dividend puzzle.

Turkey European Union Relations within the Context of the Central Asian Countries

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Abstract

The purpose of this paper, in the light of recent developments, is to analyze whether or not there is an axial drift in Turkey, which is a part of Europe. With the decision of the Parliament of the Federal Republic of Germany, after that the collapse of the wall, known as the iron curtain, was built on August 13,1961 in Berlin and the Soviet Union disintegrated on the date of December 25, 1991, and a new unipolar restructure came into view. New hopes, uncertainties and new threats were brought along by the US-led restructuring. The Cold War period ended, a drastic change process with the Eurasian axis in the international relations started to be lived in, and the world order based on the the nuclear balance between the East and the West also died out. Having located at the intersection point of Europe and Asia, and therefore of strategic importance, Central Asia has been bringing together the two continents for centuries. In this geography, Turkey has been the first country to recognize the Republics that have gained their independence for the last 20 years. Starting in 1991, the relations between Turkey and Central Asia countries progressed swiftly. Turkey, on the one hand, has been developing the economical and political relations with the aforesaid countries, but on the other hand, it has also been continuing to progress on the course of being granted a full membership to the European Union. Turkey has been the only Muslim country to head towards the West since Tanzimat (the Reformations in 1839). Besides, Turkey, by having preserved the cultural values, having adopted the democratic principles, having a common border with the Western world and being her neighbour, is the only and the most developed country to have choosen the West on the economi, cultural, social and sporting areas among the 57 Islamic countries existing on the world. Turkey, with different political and economic systems, is ready to contribute towards ensuring peace and economic prosperity in Central Asia and Eurasia. The diplomatic activity demonstrated by Turkey in its region was interpreted by some parties as undergoing a shift in the axis of the country and becoming Islamized. The development preparing the ground for the emergence of the axis debates in Turkey is that the relationship between Turkey and EU has come to a dead end. While about 73 percent of the public supporting for full membership in the years of 1999-2005, this proportion dropped to 43 percent in recent years. Without the support of the public opinion, no government in the Republic of Turkey will be enthusiastic about the EU membership, as it is, the relations between Turkey and the Western world will decline and the axis shift in Turkey will perhaps become a fact in this case. For this reason, an initiative, called Positive Agenda, was launched for the purpose of not breaking off the relations and preventing Turkey from setting sail for new shores. This new approach is not targeting to replace but to complete the accession process, and the development of the more constructive and positive relationship between EU-Turkey is targeted as well. The world's economic axis will shift from the West to the East in the next 50 years. The harsh criticism of the double standards of the West voiced by Turkey in the non-Western regions such as the Middle

East, the Balkans and the Caucasus is causing to be perceived by the Western world as that Turkey is not a partner but a competitive power and as for that the close relationship with the groups and the actors against the West in the Middle East is leading to interrogate about what kind of partner it will be in Europe. When NATO was formed 63 years ago, the collapse of the Soviet Union in 1989, that the Central Asia countries would gain their independence, that two-block structure of Europe would disappear and that the Warsaw Pact would disband could not be predicted by no one. Axis is shifting from the West to the East. By realizing this fact, Turkey has to determine a new strategy. As a result, in our statement, the position of Turkey, which is a part of Asia and Europe, against the latest development in the region will be analyzed.

Currency Choices in Valuation: An Approach for Emerging Markets

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Abstract

One of the common decisions that multinational companies face is whether to value an investment or an acquisition in a foreign or an emerging market in the domestic currency or U.S. dollars. The choice of currency affects the inputs. Since these investments generate sales, expenses, and cash flows in domestic currency, senior management is required to express expected cash flows in a strong currency, usually dollars. Therefore, it is necessary to forecast the exchange rate for the investment horizon. In this paper, we demonstrate the equivalence value independent of the currency used in the valuation. This is done through using an arbitrage-free pricing model to obtain a fair value for the business. Users of the model assume the simultaneous fulfillment of Interest Rate Parity theory (IRP) and Purchasing Power Parity theory (PPP), which implies a constant real exchange rate (RER). This model can be extended to explore the effect on the business value as a consequence of a depreciation or appreciation of the currency.

The Effect of High Frequency Market Making on Option Market Liquidity

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Abstract

The transition from manual to electronic markets in options paved the way for pricing efficiencies and improved liquidity from options high frequency market making (HFMM). We find that HFMM reduces option bid-ask spreads, although with differences across both option and firm characteristics. Moreover, depth increases with quote revisions, conflicting with extant equivalent research in other markets. The largest absolute change for spreads (depth) is for mid-size (large) companies. However, the change to penny quotes causes HFMM to have less of an effect on both spreads and depth, showing that penny quoting exacerbates the pricing efficiency generated by more frequent quote revisions.

Real Options: An Alternative Valuation Model for REITs Empirical Evidence from the US Market

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Abstract

REITs are alternative investments that offer asset managers high returns and diversification opportunities. In an active management process, securities selection and more specifically their valuation is a key component of future performance. In this paper, we propose a model that combines a DCF model with real options in order to take into account the different drivers of real estate investment value, such as net asset value, future rentals income and capital expenditures policy. Our theoretical model for REITs provides an average spread around 16% compared with the market value.

Culture and Property Rights Institutions

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Abstract

We explore society's cultural moral code as a possible explanation for the prevalence of the rule of law. At a general equilibrium level, we show that a greater cultural emphasis on guilt may increase aggregate rent seeking, inhibit the establishment of strong property rights institutions, discourage the adoption of human capital and reduce overall social welfare. The impact of a greater cultural emphasis on pride is in the opposite direction.

Institutional Trading and Asset Pricing

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Abstract

The relation between beta and average return is strong and positive on days with high institutional trading activity. In contrast, on normal days, this relation is negative and statistically signi cant. Days with interest rate announcements also exhibit the positive relation. However, we show that the e ect of institutional trading is the primary driver of the upward sloping security market line on announcement days. We explore potential explanations and nd that our ndings are most consistent with the leverage-constraints hypothesis.

What Drives Corporate CDS Spreads? Comparison Across US, UK and Eurozone Markets

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Abstract

This study examines the determinants of quarterly corporate CDS spreads in the US, the UK and the EU during the recent financial crisis. Our analysis reveals that accounting and market-based variables are significant predictors of CDS spreads during periods of financial distress. We note that the significance of the variables varies considerably across each period of analysis and across each market. We further note a substantial portion of CDS spreads that cannot be accounted for in the post-crisis period across all three markets even after accounting for CDS market liquidity dynamics. We also study the characteristics of the default and the non-default components of yield spreads before, during and after the financial crisis and note that they follow a similar trend. We find the default risk only partially explains the movement in yield spreads and the non-default component is a key driver of bond yield spreads more so in the crisis and the post-crisis era. By regressing the non-default component of the yield spreads against liquidity proxies, we find a significant effect of liquidity on the non-default component not only during the crisis period but also in the post-crisis period for all three markets. We find that the CDS spreads have overreacted during the financial crisis.

Long - Term Co-movements Between Stock Indices,Industrial Production and Inflation of Latina Amrican Countries

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Abstract

A number of studies have examined the relationship between financial markets and macroeconomic variables. For instance, Chen, Roll, and Ross (1989) suggest that equity returns are endogenous to economic variables as these economic factors affect the pricing of goods and services which in turn influence dividends either positively or negatively. Since stock prices are the present value of expected future dividends discounted at an appropriate interest rate, the economic factors are indirectly incorporated in these prices. The discount rate on the other hand, can change due to the level of unanticipated changes in interest rates and the risk premium. The level of real changes in consumption or spending will influence the production of goods and services, its pricing in turn can affect the unanticipated changes in risk premium

Efficiency and Competition in the Dutch Non-Life Insurance Industry: Effects of the 2006 Health Care Reform

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Abstract

This paper investigates the cost efficiency and competitive behaviour of the non-life – or property and casualty – insurance market in the Netherlands over the period 1995-2012. We focus on the 2006 health care reform, where public health care insurance has been included in the non-life insurance sector. We start with estimating unused scale economies and find that after the health care reform in 2006, unused scale economies are, at 21%, much higher than before the reform (4%), pointing to a relative increase of fixed costs. Scale inefficiencies are generally higher for smaller insurance and lower for large insurance companies. As a benchmark, we also estimate scale economies for non-health lines of business (LOB), which range from 5% to 10%. To measure competition directly, we apply a novel approach that estimates the impact of marginal costs as indicator of inefficiency on either market shares or profits. Over time, competition in health insurance has increased significantly, but the inclusion of the (non-competitive) public health care funds in the health insurance sector in 2006 caused a fall in the average level of competitive pressure. After the reform, competition continued to improve. In the non-health LOB non-life insurance, we find similar significant effects of efficiency on both market shares. The non-life effects are weaker than in life insurance, banking and non-financial sectors, suggesting less heavy competition

Managerial Characteristics and Corporate Cash Policy

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Abstract

There has been a surge of research on corporate cash holdings in recent years. While most previous studies mainly focus on the relation between firm characteristics and corporate cash policy, few empirical studies explore the effects of managerial characteristics on corporate cash holdings. We contribute the related literature by considering the managerial characteristics, such as age, tenure, confidence, and education, and conduct empirical tests to investigate their effects on corporate cash policy. We find that firms managed by CEOs with longer tenure and by overconfident CEOs tend to have higher levels of cash holdings. However, firms managed by CEOs with MBA degree tend to preserve less cash. Our study shows mixed evidence on the relation between the age of managers and corporate cash holdings. Further analyses suggest that senior and longer-tenured CEOs are more likely to hold cash for precautionary motives, but overconfident CEOs do not preserve cash for such reason. In addition, CEOs with MBA degree seem to invest more when their firms have excess cash. Overall, this paper provides intriguing empirical evidence for the effects of managerial characteristics on corporate cash policy.

How do Firm Characteristics Affect Capital Structure? Indian SMEs Evidence

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Abstract

We examine factors that influence the capital structure decisions of SMEs for an important emerging market like India. We conduct a panel data regression to study the impact of profitability, growth opportunities, size, asset structure and business risk on total as well as long-term and short-term debt used as proxies for capital structure decisions of a company. Our results show that Indian SMEs that are bigger in size with numerous growth options and least operational risk rely more on long-term debt. On the other hand, SMEs earning high profits and bearing high business risk do not resort to external financing even through short-term debt. We also find that size of a company and business risk are the two most important determinants of capital structure decisions for Indian SMEs that are similar to large manufacturing companies globally.

Value-At-Risk Forecast Using Copulas: An Empirical Approach in Brazilian Stock Market

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Abstract

Through empirical research is identified that the hypothesis of normal distribution of returns is no longer observed while verifying the existence of heavy tails and asymmetries in the distribution. Thus, the article has aimed empirically apply copula models using techniques of realized volatility (HAR) with high-frequency data and perform the calculation of Value at Risk for different periods. The results show that HAR models copula exhibited superior performance with respect to EWMA and GARCH in intervals of time greater than five minutes.

Market Risk Exposure: Evidence from CNX500 Corporates

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Abstract

This paper attempts to ascertain the exposure of different Indian industries to various market risks, namely, interest rate (short term), inflation rate and fluctuation in exchange rate. In view of the growing significance of risk management, it is important that companies benchmark themselves and their risk management practices. From the policy making perspective at macro level, it may facilitate the Central Government and regulatory bodies. Also, this may be a significant input for investors in portfolio formation and optimization process. The sample for the study consists of non- financial constituents of CNX 500 index. The study uses monthly data for the period April 1, 2005 to March, 31, 2014. Employing, pooled data regression on 30456 observations, while using OLS techniques (with white's heteroskedasticity consistent errors and covariance), the aggregative analysis reveals significant exposure to interest rate risk. In phase wise analysis, pre- recession phase (2005-2008) portrays insignificance of fluctuations in exchange rates, whereas all the risks are statistically significant in post- recession phase (2008-2014). Industry wise analysis (based on 14 industry groups) reveals that by and large there is a negative and significant impact of short term interest rates on different industry groups. Inflation rate is statistically significant only for chemical, metal, healthcare, ICT and diversified industries. Exchange rate fluctuations have significant impact only on capital goods industry. Financial companies have been separately analyzed and demonstrate significant exposures to all the stated risks.

Banking Crises & Contagion: Why Worry About Taxation, Output and the Cost of Capital?

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Abstract

The prediction and consequences of banking crises continue to be a fab in academic and political discussions. Researchers attempt to describe the link between these crises and the real economy. In this paper, we present an object oriented model that attempts to establish the relation of the real economy to banking crises and contagion. We describe a set of extensions to VBanking, an object oriented model which can be used to carry out simulations on the banking system of a hypothetical economy. We expand our existing work by proposing the way the model will link the banking system and the real economy, incorporating fiscal issues. We briefly present the empirical results of the current model and discuss the outcome from the proposed expansions. Our findings place some criticism on the ability of the regulatory measures of Basel III to prevent or handle banking crises. However, these measures do seem to contribute to a more stable path for the financial institutions and for the economy.

The Economic Effects of Foreign Bank Entry on the Egyptian Banking System: Empirical Analysis

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Abstract

This paper investigates the impact of foreign entry on the Egyptian domestic banks by using panel data on 9 domestic commercial banks from 1998 to 2010. The paper will assess the impact of foreign bank entry on the banking sector in Egypt through two channels, namely the competition and spillover effects. Our results suggest that the increase in foreign presence lead to lower profits and costs. This finding is consistent with empirical studies on the impact of foreign entry which shows that foreign ownership seem to exert competitive pressure and that domestic banks improved cost efficiency to enable them to compete in the new environment. We find that competition effects, which may reduce both the profitability and overhead costs of domestic banks, dominate the spillover effects that may raise the profitability and reduce the overhead cost of domestic banks.

Stock Prices, Investor Short-termism, and Innovation

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Abstract

Firms can change their outstanding shares to manage their stock price levels. Those with lower stock prices tend to attract more speculative trading, which causes higher price volatility and may force their managers to excessively focus on short-term earnings at the expense of R&D and other long-term projects. Thus, we hypothesize that firms investing more in R&D prefer to set higher stock prices to mitigate investor short-termism and enhance R&D productivity. Indeed, we find that firms with more R&D capital tend to keep higher stock prices and are less likely to split their stocks to lower prices. Furthermore, high-priced firms are less likely to cut R&D to reverse an earnings decline, and less likely to fire their CEOs in the presence of poor earnings. More importantly, firms' R&D productivity—in terms of generating patents and patent citations—tends to increase with their stock prices, even after controlling for firm valuation, stock returns, stock liquidity, and institutional ownership. For robustness checks, we examine stock splits, which allow mangers to re-set their stock price levels, and IPOs in which managers set an offering price range before shares are publicly traded. Consistent with our hypothesis, we find that IPO firms setting higher offering prices have more future innovation and that innovation declines after firms split their stocks. Thus, our results imply that managers of R&D firms actively support high stock prices to foster innovation, and support Warren Buffett's wisdom that firms can use stock prices to attract preferred clientele.

The Geometry of Interest Rate Risk

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Abstract

In this paper we consider the process of interest rate risk management. The yield curve construction is revisited and emphasis is given to aspects such as input instruments, bootstrap and interpolation. For various financial products we present new formulas that are crucial to define sensitivities to changes in the instruments and/or in the curve rates. Such sensitivities are exploited for hedging purposes. We construct the risk space, which eventually turns out to be a curve property, and show how to hedge any product or any portfolio of products in terms of the original curve instruments.

Defence Sspending and Economic Growth in Nigeria: Is there Any Relationship ? Vector Error Correction Model (VECM) Aproach

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Abstract

This study investigates whether there exist any relationship between defuse spending and economic growth in Nigeria, for the period 1977 to 2010. We employed ex -post facto research design in this study as a set of some econometric techniques where actualized to investigate the relationship between defense spending and economic growth in Nigeria. The estimation regression result revealed that, Defense (DEF) and Interest rate (INT) has a positive influence on economic growth in Nigeria in the long run, while in the short run defense (DEF) and Interest rate (INT) had a negative influence on economic growth in Nigeria. However, the pairwise granger causality test indicates a bi-directional relationship between defense and economic growth, while there was no causal relationship between interest rate and defense and economic growth respectively. Also, the VEC residual normality test indicates that the residuals are multivariate and are jointly normal. The study therefore, amongst others recommend that government should increase funding on defense and if possible seek foreign aid so as to adequately tackled the menace of “Boko Haram” insurgency in the northern part of Nigeria so as attract foreign investment that would further stimulate economic growth and development in Nigeria.

Facilitating a Greener Enviromnet Through Management Accounting

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Abstract

Worldwide natural resources such as coal and water are becoming scarcer each year. Individuals as well as companies need to use natural resources sparingly and responsibly, decreasing waste production. It is not only about the usage but also about the waste that occurs. I analysed the annual statements on the websites of the Top 10 South African companies in 2012 and compared it to 2008 and 2003. A WordleTM was created for each year based on 16 key words to see whether awareness grew with regard to for instance sustainability and the environment. This paper is informational and exploratory in nature as it highlights the demand on natural resources as well as the steps that can be taken to minimise the impact on natural resources. Companies seem to become more aware of what they do to the environment and would like to take action where ever they can in order to be acceptable companies to investors. In the early years companies did what could be called "green washing" to comply with legalities however it seems that this has changed to a true awareness and "green" companies are becoming more and more competitive. In order to assist companies to become even more aware of waste and their environmental responsibility, companies may need to be made more aware of the use of management accounting tools such as Activity Based Costing (ABC) and Material Flow Cost Accounting (MFCA) simultaneously.

Dynamic Trading Strategies With Fleeting Orders

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Abstract

This study examines the behaviour of fleeting orders before and after two structural changes at the Australian Securities Exchange (ASX); the removal of broker IDs from the public limit order book and a change in the price structure of exchange fees. Following Hasbrouck and Saar (2009), fleeting orders are defined as orders that are revised or cancelled within two seconds. Firstly, this study confirms that fleeting limit order revisions exhibit similar properties to liquidity-demanding orders. Secondly, after the removal of broker IDs on the market, traders start to aggressively chase the market price. Thirdly, after the price structure changes, traders start to use fleeting orders to search for latent liquidity and more often switch from limit orders to market orders when the cost of immediate execution in the market decreases. This study is important to understand order dynamics in the current high frequency trading environment.

The Effect of Hedging on Firm Value and Performance: Evidence from the Non-financial UK Firms

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Abstract

The paper evaluates the effect of hedging activities with financial derivatives instruments on firm value and financial performance, using a sample of 275 UK nonfinancial firms listed in the FTSE-All share index for the period 2005-2012. We focus on the hedging of the foreign exchange (FX), interest rate (IR) and commodity price (CM) risks with futures, forward, option and swap contracts. Forward contracts are most used in hedging FX and CM, while options and swaps are common used in hedging IR risks. Most importantly, our findings show mixed results for implementing various derivatives types contracts and the effectiveness of hedging financial risks based upon the risk management practices on the choice selection of derivatives instruments. Overall, we provide strong evidence that forward contracts in hedging FX has statistically positive impact on firm value and performance but with negative effective with CM risks. We also find weak evidence that options and swaps contracts for IR risks could support value creation for investors.

Reading Russian Tea Leaves: Assessing the Quality of Bank Financial Statements with the Benford Distribution

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Abstract

Benford's Law, a rule concerning first digits of an array of numbers, has frequently been used to test for the reporting quality of financial statements. When applied to the recent experience for Russian banks, one conclusion is that the 2004 regime shift in accounting standards produced higher quality financial statements. Nevertheless, there is some evidence that shading of numbers still goes on and that Russian banks tend to overstate net income and equity capital. In a second part of the analysis, the practical use of Benford to discern a looming bank failure appears limited. While there is, perhaps, some beneficial information to be drawn from testing for Benford distribution conformity, in isolation the tests for financial statement manipulation are inconclusive. Instead, Benford might be used with other early warning detection algorithms to recognize impending bank failures.

Prestige without Purpose? Reputation, Differentiation, and Pricing in U.S. Equity Underwriting

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Abstract

Clustering of IPO underwriting spreads at 7% poses two important puzzles: Is the market for U.S. equity underwriting services anti-competitive and why do equity underwriters invest in reputation-building? This study helps resolve both puzzles. Modeling endogeneity of firm-underwriter choice using a two-sided matching approach, we provide strong evidence of price and service differentiation based on underwriter reputation. High-reputation banks receive average reputational premia equaling 0.65% (0.47%) of average IPO (SEO) underwritten proceeds, which constitutes 10% (13%) of their underwriting spreads. Equity issuers working with high-reputation underwriters receive significant benefits, including higher offer values and lower percentage spreads net of reputational premia

Do Russian Science Cities and Special Economic Zones correspond to their scope

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Abstract

The main aim of this article is to create methodology which allows to find out if Russian municipal government use all their powers to stimulate innovative activity of the local enterprises. We use statistical data about territory development reported by several Russian municipalities which was granted the status of Science City by Federal Government or created Special Economic Zone on the part of their territory also by permission of the State. Our main interest is to find some relationship between performance of the local enterprises and different policies of the municipality. If there were any influence, it would be useful to find which policies of locally-appointed officials give main influence on the enterprise performance. Since many previous studies confirmed that the choice to open new business in particular territory is based not only on tax incentives or other economic stimulus, but also on cultural, ecological and similar concerns about territory, our other interest is to find out if local government put enough effort to develop municipalities comprehensively. We use tradition statistical technics such as ANOVA, logistic regression and linear regression to create evidence that there are some connections between enterprise financial performance and local government policies of the Russian Science City and Special Economic Zones. We found out also, that mostly attractive policies for innovative enterprises were tax incentives and construction of apartment houses for local inhabitants. Other local government duties such as culture development, water and natural gas supply and so on are not important for financial performance of the enterprises. In consequence, we conclude that Russian municipalities don't pay enough attention to other than economic stimulus policies that can explain poor performance of such development institutions in Russia as Science Cities and Special Economic Zones.

Time Variation of Expected Returns on REITs: Implications for Market Integration and the Financial Crisis

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Abstract

This article uses conditional multifactor asset pricing models to examine the time variation of expected returns on REITs and test the hypothesis of market integration for the period 1972-2013. Although expected returns on equity REITs are highly correlated with their own volatility, the covariances of returns on REITs with the Fama-French factor-mimicking portfolios subsume the role of the volatility of REITs in explaining the time-varying expected returns on REITs. The systematic risks associated with the Fama-French portfolios contribute to approximately half of the volatility of REITs during periods of low volatility of REITs but more than 80 percent of the volatility around the peak of the financial crisis. The conditional betas of REITs, along with the conditional correlation between the stock market risk premium and the value premium, are more important than the volatility of the Fama-French portfolios for explaining the time variations of expected returns and volatility of REITs. Tests of asset pricing restrictions enhance the existing evidence on the integration of the real estate market with the general stock market.

Can Microfinance Reduce Economic Insecurity and Poverty? By How Much and How?

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Abstract

The paper suggests that, rather than through its narrow, direct financial impact, microfinance may prove to be more potent in reducing insecurity and poverty through its indirect, broader impact enhancing the socio-economic position of the poor, enabling them to have better access to private and public sector resources, and thus promoting a more egalitarian initial endowment distribution that is necessary for the "take-off" of an equitable growth process. In arriving at this suggestion, the paper begins by examining the distinctive roles of micro credit, micro savings, and micro insurance programs in dealing with poverty and insecurity, and highlights the complementariness that exists among these roles and how this complementariness can be used to overcome the weaknesses of the individual programs. The paper notes that the immediate financial impact of microfinance has been important, though probably not of first order importance in reducing poverty and insecurity.

Same Rules, Different Enforcement: Market Abuse in Europe

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Abstract

We present and analyze a novel set of enforcement data from the European Securities Market Authority during the period following the European Union's harmonized rule setting on securities market abuse. The data show significant differences in the intensity of enforcement across Europe. The empirical tests are highly consistent with the view that the intensity of enforcement is the most statistically robust and economically significant predictor of market abuse detection. In particular, the data identify three important arms of enforcement: the number of supervisors, which enhances detection; formalized cooperation, which facilitates surveillance; and imprisonment, which facilitates deterrence. We discuss research, practitioner implications, and policy implications for securities regulation across several key European countries.

Transmission of Financial Stress in Europe: The Pivotal Role of Italy and Spain, but not Greece

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Abstract

This paper proposes a stochastic volatility model to measure sovereign financial distress. It examines how key European sovereign credit default swap (CDS) spreads affect each other; specifically, the paper analyses the volatility structure of Germany, Greece, Ireland, Italy, Spain and Portugal. The stability of Germany is a close proxy for the resilience of the euro area as markets use Germany's sovereign CDS as a hedge for systemic risk. Although most of the CDS changes for Germany during 2009–12 were due to idiosyncratic factors, market developments in Italy and Spain contributed significantly, likely due to their relative importance in the region. Changes in Greece's sovereign CDS had no significant effect on Germany's sovereign CDS despite initial widespread concerns about such linkages. Spain and Italy show a notable co-dependence in explaining each other's volatility while Germany also plays an important role. It is found that extreme bad news led to persistent and nearly permanent effects on the stochastic volatility of European sovereign CDS spreads.

Government Ownership and Venture Performance: Evidence from China

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Abstract

Prior literature has examined government supported (as opposed to owned) VCs in developed markets. We use the venture capital (VC) market in China to analyze the performance of government owned VCs and their portfolio companies in the context of the largest emerging market, which has significant political and economic risks. We find that the impact of government ownership depends on whether the fund is wholly or partially government owned and whether the owner is at the central or provincial level. Partially (though not wholly) government owned VCs improve venture success, e.g., the likelihood of exit via an IPO and the likelihood of exit in mainland China. Investment from VCs with local government ownership is associated greater exit-success, but this advantage diminishes as the number of local VCs increases. Government owned funds exhibit worse performance at the fund-level. Our findings suggest that government VCs in emerging markets may benefit through political connections that enable them to navigate discretionary regulations, but that excessive government control leads to inefficiencies.

Credit Rating Changes and Stock Returns of US-listed Banks

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Quentin Mulet-Marquis
,

Abstract

We provide empirical evidence of abnormal returns associated with credit rating changes for US-listed banks for a sample of 264 credit rating announcements by 43 international and US banks between 2000 and 2012. We find short-term negative abnormal returns are exhibited to downgrades and positive abnormal returns are exhibited to upgrades on the day prior to the event. Negative abnormal returns to downgrades are smaller if the downgrade is preceded by an addition to the Credit Watch List. We find increased post-announcement abnormal return volatility to possible downgrades which may reflect the variety of opinions regarding the outcome of the future rating. Positive post-announcement abnormal returns are exhibited to upgrades, contrasting with the theory that good news related to upgrades are impounded into stock prices prior to announcement.

Valuation Effects of Corporate Social Responsibility

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Abstract

This paper develops a valuation model of the firm that provides for the expenditure of corporate resources in support of community, social or environmental causes. We show that under certain circumstances CSR expenditures create value for the firm. We also test our model by simulations and confirm that, at least under some conditions, CSR does pay off in the form of value creation.

Investor Protection and Firm Performance:Evidence from China's Cross-Border Mergers and Acquisitions

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Abstract

Using a sample of 1470 cross-border mergers and acquisitions from 1997 through 2011, it finds two distinctive features of the financial market in China. First, better investor protection mechanisms at target countries, such as better law and order conditions, lower public sector corruption and better protection of creditor rights, are not creating wealth for shareholders of bidding firms around China's outward cross-border mergers. Second, firm-level corporate governance mechanisms are more related to the valuation effects than the country level investor protection indicators and hence are central in explaining firm values in China.

Does Corporate Governance Still Affect Firm Performance After Controlling for Distress Factor?

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Abstract

We explore the impact of corporate governance on firm performance. We first identify whether corporate governance can still be an influential factor or has been largely captured by the traditional Fama-French three-factor model. More importantly, our study adds a financial distress factor to the Fama-French three-factor model to form a four-factor pricing model (labeled as "financial distress four-factor model"). We find that for the US Russell 1000 firms the financial distress four-factor model is the better model of the two models considered. We further find that the financial distress four-factor model has the higher explanatory power in capturing the return variation. By comparing two chosen pricing models, we find that the differences between the return of firms with good (weak) corporate governance and expected return are insignificantly different from zero for most portfolios in all the two models. Between them, the financial distress four-factor model, however, has the fewer portfolios with return difference being significantly different from zero, implying corporate governance has been better priced in the financial distress factor.

Examining the relationship between Hedge Effectiveness, Price Trend and Time-to-Maturity of Equity Futures Contracts: Evidence from National Stock Exchange of India

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Abstract

Present study examines the relationship between hedging effectiveness, price trends and time-to-maturity of futures contracts by using three indices (namely S&P CNX NIFTY, CNXIT and BANKNIFTY) for near, next and far month contracts over the sample period January 2000 – June 2014. The hedge ratios have been calculated by using eight methods namely; Naive hedging, Ederington's Model, ARMA-OLS, VAR, VECM, GARCH (p,q), EGARCH (p,q) and TGARCH (p,q). The study finds that near month futures contracts are more effective tool for hedging as compared to next and far month contracts. These findings imply that for efficient hedging, liquidity plays more prominent role than hedge horizon. The study finds an improvement in hedging effectiveness during post crisis period which is also accompanied by an increase in cost of hedging which implies that during high volatility period hedging effectiveness also improves. The study also finds that time-invariant hedge ratio is more efficient than time-variant hedging. Therefore, knowledge of sophisticated econometric tools does not help to improve hedge effectiveness.

The Brilliant Mind of Investors

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Abstract

Combining two exhaustive datasets from NASDAQ OMX Tallinn and Estonian national educational registry we dig deeper into the behavior of the individual investor and paint a picture about how mental abilities in very different areas influence stock market participation. We use different tools of statistical analysis including probit regression models to determine what distinguishes investors from other people. The main contribution of the paper is a substantial step forward in determining how education and mental abilities influence stock market participation. We prove that investors achieve significantly higher results in their national final high school exams than non-investors. This is consistent with our main contribution – we offer strong evidences that people with higher mental abilities in very different areas are more likely to participate in the stock market. The most important factors for stock market participation are mathematics and physics. Finally we conclude that investors are not only more educated as found in previous studies, but investors also outsmart other people in every field, including both so called soft and hard sciences.

Opness and Banking Sector Development in Africa: A Re-Examination of Simultaneous Oppness Hypothesis Using Dynamic GMM in a Panel of Forty Six African Countries

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Abstract

There are calls for studies on liberalization-financial sector development relationship. Empirical results on openness- finance relationship are scanty and contentious. Again, most previous studies were focused on developed or emerging market economies while little attntion is given to African developing countries. Furthermore, Rajan and Zingales proposed the simultaneous openness hypothesis as a recipe for a positive impact of liberalization on financial sector. Thus, these necessitate for calls for more researches in openness-finance relationship. This study investigates the impact of trade and financial liberalization on banking sector development among African developing countries. Using panel data from 2002-2011 among forty six (46) African countries and employing dynamic GMM estimators, the results showed that trade and financial sector openness is statistically insignificant to banking sector development. Further, we find no evidence in favour of Rajan and Zingales's proposition of simultaneous openness hypothesis.

Pricing of guarantee options in defined contributions pension plans

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Abstract

The shift from defined benefits (DB) to defined contributions (DC) is pervasive among pension funds, due to demographic changes and macroeconomic pressures. In DB all risks are borne by the provider, while in plain vanilla DC all risks are borne by the beneficiary. For DC to provide income security some kind of guarantee is required. While the relation DB-DC is typically viewed as a binary one, the design of guarantee options make this relationship continuous. A minimum guarantee clause can be modeled as a put option written on some underlying reference portfolio of assets. In this paper we propose a discrete model that optimally selects the reference portfolio to minimise the cost of a guarantee. The model setup can be used to price a wide range of guarantees in the continuum DB-DC. Integrating guarantee pricing with asset allocation decision is useful to both pension fund managers and regulators. The former are given a yardstick to assess if a given asset portfolio is fit-for-purpose; the latter can assess differences of specific reference funds with respect to the optimal one, signalling possible cases of moral hazard. We develop the model and report extensive numerical results to illustrate its potential uses.

The Impact of Corporate Governance on Financial Performance of Islamic Banks: Some International Evidence

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Abstract

Abstract This study investigates the impact of selected corporate governance (CG) variables on the financial performance of Islamic Banks measured in terms of ROA & ROE. The corporate governance measures used include (1) board size; (2) presence of female board members; (3) duality of the CEO; (4) block holders; (5) the existence of Shari'ah (Islamic Law) committees and (6); size of the Shari'ah committee. The study is based on a sample of 102 Islamic banks from 24 different countries worldwide for the period 2008 - 2012. Data was analysed through the use of partial correlation and T- test and an econometric model specified to calculate regression equations through Multiple Regression analysis. The findings indicate that some variables such as board size and block holders have impact on financial performance while duality was found to only partially affect the ROA. Other independent variables were found not to have any influence. This study' contribution to the relevant literature includes: First, it is the first study that investigates mainly the effect of corporate governance and financial performance of Islamic Banks. Second, it examines some corporate governance variables that were examined for the first time such as the existence of Shari'ah committee and size of the Shari'ah committee. Finally, this study reports some recommendations for further research.

Extreme Daily Returns and the Cross-Section of Expected Returns: Evidence from Brazil

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Abstract

This paper examines whether extreme (positive) daily returns predict the cross-section of monthly stock returns in Brazil. We find a negative effect of the maximum (MAX) daily return on future performance in line with recent studies in the U.S. and Europe. High MAX stocks appear to cater to some investors that look for lottery-like stocks as extreme positive returns stocks offer the potential of substantial gains with a low probability. Increased demand leads to overpricing and ensuing lower returns to lottery-like stocks. Other proxies for extreme returns like idiosyncratic volatility and skewness play a much weaker role (if any) as cross-sectional determinants of stock performance. We document that the MAX effect is significant only during economic contractions suggesting that gambling behavior in the stock market exacerbates during economic downturns.

Understanding the Price Momentum-Reversal Phenomenon: Insights from U.S. Stock Markets

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Abstract

This study investigates the nature of the momentum-reversal phenomenon of U.S. stock returns. We use long-short portfolios to replicate and extend the results of past studies showing positive short-term price momentum and long-term price reversals. We illustrate that stock portfolios constructed first by sorting firm characteristic and then by returns are not global winner-loser portfolios, and thus are unable to address the price momentum-reversal phenomenon. In contrast, portfolios constructed first by sorting by return and then by firm size are global winner-loser portfolios. We examine various long-short portfolios and find that the size effect dominates the momentum effect.

Profitability of Mining Enterprises in Developed and Developing Countries

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Abstract

It was accepted that profitability of enterprises in extractive sectors of developing countries should be, in general, higher than profitability of enterprises in developed countries, and the standard explanation was that there is a higher risk taken by firms in developing countries. On the other hand, evolution of the country-risk variable in Peru shows that there is an approximation of the rates of return in Peru -bonds and stocks- to the rates of return prevailing in developed countries such as the US. The hypothesis of this article is that the rate of return on investment in Peru, in extractive sectors, is today still higher than the rate of return on investment in the US. The conclusion of our research is that there exists a significant difference between the rate of profit for mining investments in a developing country, such as Peru, with respect to mining investments in a developed country, such as the US.

Financial Literacy in Southern Brazil: Modeling and Invariance Between Genders

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Abstract

Financial literacy is an essential attribute that allows people to reach a successful financial state. Therefore, the objective of this article is to develop a model to measure financial literacy, testing invariance in the proposed measure from three scales: financial knowledge, financial attitude and financial behavior. In this sense, a survey was conducted with 991 individuals who live in southern Brazil. The tests indicated that the model to measure financial literacy showed significance in all relations proposed, and in the models, female or male gender was invariant. However, male individuals showed a higher level of financial literacy on average compared to females.

Bank Ownership Structure and SME Lending: Evidence from Local Credit Markets

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Abstract

The paper investigates the relationship between bank type and small-business lending in a post-transition country. Using a unique dataset on bank branches and firm-level data, it reports that local cooperative banks lend more to small businesses than do large domestic banks and foreign-owned banks, even when controlling for the financial situation of the cooperative banks. Additionally, the results suggest that cooperative banks provide loans to small businesses at lower costs than foreign-owned banks or large domestic banks. Finally, the evidence portrays that small and medium-sized firms perform better in regions (counties) with a large number of cooperative banks than in regions dominated by foreign-owned banks or large domestic banks. These results are important from a policy perspective, as they show that foreign bank entry and industry consolidation may raise valid concerns for small firms in developing countries.

Index Options Realized Returns Distribution From Passive Investment Strategies

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Abstract

Many studies analyze and provide the basis for the calculation and valuation of options, but few provide data about option´s payoffs and their realized returns based on passive investment strategies, providing information on how options performed with respect to the some measure of capital invested. Though these studies are found with more frequency for equities, they are scarce for options. Our research objective in this paper is to collect evidence and study the payoffs of option´s contracts such as calls and puts, assuming there are kept by an investor until the expiration of the maturity and hence providing the basis for the calculation of the distribution of realized returns of those contracts. The investment strategy consists in selling options at contemporaneous market prices, invest the margin required, keep them until expiration and evaluate the payoffs. Specifically, we want to show the distribution of realized returns (ex ante prices vs. ex post returns) of options, and to open some future research propositions relating the risk and the expected return. To do so we analyze at the money naked call and put options written on the three main equity indexes of the United States capital markets, evaluated with three different maturities for a very long period of time. We get a distribution of realized returns, and we find that selling puts becomes more profitable than selling calls, without adjusting for the return of the underlying asset and for the risk free rate of return, something in line with what was expected, but we also find that the risk is approximately the same. We find that time tends to increase the realized returns, measured everything on annual basis, and finally, we also provide basis for the discussion of what has to be considered options returns.

The Market for "Lemons": A Study of Quality Uncertainty and the Market Mechanism for Chinese Firms Listed in the US

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Abstract

ABSTRACT Akerlof's (1970) seminal work provides a framework for market failure as a consequence of quality uncertainty. We hypothesize and find that a classic "Lemons" market occurred in recent Chinese firms listed in the US. Our study provides empirical evidence of a rarely documented market failure - Chinese firm US IPOs almost became extinct in 2012. Our tests reveal that there is little difference in ex ante observable characteristics of non-fraudulent versus fraudulent firms when the Chinese firms were listed while entrepreneurs know their type, consistent with their ex post privatizations. Our evidence indicates the existence of severe information asymmetry and substantial costs of dishonesty. We find little evidence that traditional market mechanisms such as short selling behavior, auditor quality or underwriter reputation provide credible signals of firm quality. We further find that factors capturing potential ex post settling up costs such as North America sales and CEO's US education reduce the probability of financial fraud. Our findings support efforts by Chinese and U.S. regulators to improve the quality of Chinese firm financial reporting and audit quality. Finally, our results highlight the importance of the ability to enforce legal sanctions for financial fraud in contemporary capital markets.

The Boss Knows Best: Directors' of Research Industry Expertise and Sell-Side Analysts

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Abstract

Sell-side research analysts report to a Director of Research (DORs) whom are often former sell-side analysts. We construct a novel sample of DORs, extrapolate their industry experience based on their previous sell-side experience and match this with their subordinate analysts' portfolios. Analysts that work with DORs possessing the same industry experience provide superior earnings forecasts, more informative recommendations, and are more likely to experience favorable career outcomes. For identification, we exploit a natural experiment that alters the availability of industry-expert DORs. Analyst accuracy improves (worsens) when a DOR with the same industry experience joins (leaves) a broker. Our paper identifies a channel whereby industry expertise filters from upper management down to individual-level subordinate performance.

Why We Need a World Exchange and World Custodian

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Abstract

The world's exchanges and custodial arrangements currently suffer numerous and serious shortcomings. Opaque instruments are still traded opaquely over the counter. Bond trading remains in the stone age and foreign exchange and metals price rigging has been persistent. Private exchanges pay for order flow and sell information to favored traders. High speed traders fleece individual and institutional investors some of whom try to seek protection in dark pools. Liquid and transparent markets are still lacking in important metals and commodities. Investment advice is often tainted by conflicts of interest. Custodial services suffer from serious shortcomings as well. Metal stocks have been physically moved around warehouses to lengthen storage time for profit. Delivery schedules for aluminum have been inordinately long. Funds in customer accounts have been lost or embezzled. The world's largest bond fund is under investigation for mispricing. Government regulation and oversight have not solved, and cannot fix, these shortcomings. But as I will argue in this paper, a simple, efficient, transparent, and secure solution is attainable with respect to both exchange and custody: the establishment of two linked institutions, a world exchange and a world custodian, both independent and not-for-profit. A single global exchange for stocks, bonds, futures, options, currencies, and metals can overcome these shortcomings when operated by an automated market maker. And a direct link to a world custodian for all securities and physical commodities traded on the world exchange can insure maximum security. The net result will provide much improved price discovery, liquidity, transparency

Bidders and Targets Made for Each Other: Credit Ratings, Growth Opportunities and Acquisition Returns

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Abstract

This study investigates complementary acquisitions that are related with improvements in financing efficiencies and growth opportunities of bidding and target firms. Using credit rating levels as a measure of financial constraints, we find that bidders with low financial constraints and growth opportunities acquiring financially constrained target firms with high growth opportunities and information asymmetry generate higher synergy gains and bidder returns. Our results are consistent with the theoretical setting of Myers and Majluf (1984) and are robust after controlling for several factors that affect acquisition returns and potential endogeneity bias in the decision to obtain a high rating level.

EVIDENCE ON SIZE, VALUE AND STOCK RETURNS OVER CRISIS PERIODS

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Abstract

In this paper, we study the characteristics of stock returns using asset pricing models over a long period including crisis periods. Especially, we test the three factor model of Fama and French (1993) on the French Stock Market over more than three decades using panel data. We use returns on 25 portfolios sorted by size and book to market ratio. Our study covers the period from July 1980 to June 2013 (396 months). We show that size and value e ffects are more signi cant when stock markets are febrile. The three factor model explains better the common variation in stock returns especially over crisis periods. Moreover, in cross-section regressions using Fama and MacBeth (1973)methodology, the three factor model has higher explanatory power that the CAPM. Finally, using the Gibbons, Ross and Shanken (1989) test, market, size and value factors explain better stock returns than one factor model. All our results show the superiority of the three factor model. In the French stock market, we show that market, size and value factors provide better description of stock returns particularly over crisis period. Finally,considering the critic of Roll (1977), we show that the choice of the market portfolio is very important.

Entrepreneurial Optimism, Credit Availability, and Cost of Financing: Evidence from U.S. Small Businesses

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Abstract

Using a large sample of U.S. small businesses and a new measure of optimism, we examine the role of entrepreneurial optimism in small business lending. We provide evidence that moderately optimistic entrepreneurs tend to have better access to credit than less optimistic ones. On the other hand, we show that lenders curtail lending to extremely optimistic entrepreneurs by charging a much higher interest rate. Our results are robust to alternative measures of optimism and controls for private information between lenders and borrowers.

Evaluating the Impact of Credit Guarantees in Chilean Firms

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Abstract

We evaluate the impact of a credit guarantee program in Chile. The paper employs a panel data that represents more than 43,000 Chilean firms in 2007 and 2009. The results for the propensity score estimation, using a Probit model, show that younger and small-medium size firms that know about public programs are more likely to use guarantees. As it should be expected, credit guarantees increase the probability of having banking debt in comparison with firms that do not have used these guarantees. We find that the differential in probability is about 74%, and the credit guarantees increase the amount of total loans from banking institutions for such firms in approximately 18% of initial total assets. However, the results do not show any significant effect on real variables –such as investment, employment and sales. Therefore, the results point out that the credit guarantee program is a vehicle to funding working capital´s firms at least at an early stage of the access to the credit guarantee program. In fact, our results indicate that credit guarantees reduce in about 19 percentage points the share of internal funds in working capital and increase in a similar amount the importance of banking credit in financing working capital.

Investor Sentiment and Price Discovery: Evidence from the Pricing Dynamics between the Futures and Spot Markets

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Abstract

This study shows that investor sentiment has a positive impact on price volatility and bid–ask spread on both the spot and futures markets, which induces higher arbitrage risk and trading costs. We examine the pricing dynamics between the spot and futures markets during high and low sentiment periods. During high sentiment periods, informed traders are less willing to leverage their information advantages on the futures market to avoid exposing themselves to high noise trader risk, which diminishes the futures markets' leading informational role and contributions to price discovery. These findings provide support for the theory of limits to arbitrage.

A performance evaluation of weight-constrained conditioned portfolio optimization

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Abstract

The present paper applies an optimal control formulation previously proposed in ([2]) to solve weight- constrained versions of the conditioned portfolio optimization problem as originally studied in [3] and [1]. We compare classical optimization performance to that of strategies resulting from conditioned optimization and using several possible indicators for signaling purposes. In particular, we report on both ex ante improvements to the accessible efficient frontier as measured through the typical associated metrics such as the Sharpe ratio, and ex post results affected, most notably, by specification errors regarding the relationship between signal and returns. We also discuss the impact of different problem parameters on overall strategy performance.

Forecasting Volatility Using Nonparametric Leverage

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Abstract

This paper proposes to model the asymmetric response of the volatility to the sign of past returns (leverage effect) nonparametrically in the context of stochastic volatility models. The new stochastic volatility specification is able to generate volatility clustering and allows for a flexible functional form of the leverage effect. The forecasting performance of the new model is compared with three popular parametric asymmetric stochastic volatility models via intensive Monte Carlo experiments and empirically by fitting the benchmarks and our proposal to two series of financial returns. Both, the Monte Carlo experiments and the empirical results show that volatility models that specify the leverage nonparametrically outperform the traditional parametric specifications of the leverage.

On the Valuation of Large Systemic U.S. Banks

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Abstract

We extend Gordon's growth model of stock valuation, allowing both dividend and cost of equity to be variable over time. We establish a dynamic relationship between the price – to – book ratio of equity and measures of the cost of equity, modified dividend payout ratio and the expected growth of net income. We examine the stock market valuation of large, systemic banks in the U.S. over the period 2003Q4 – 2014Q1 and find large heterogeneity in the degree to which price – to – book ratios of these banks are temporarily above or below their long – run equilibrium valuation. These divergences are persistent over time but temporary with only about a quarter of the gap closing each quarter. We form trading strategies, based on the model, which lead to predominantly positive returns. We find that the price – to – book ratio of equity is a valid valuation model.

Cash Management and Payment Choices: A Simulation Model With International Comparisons

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Abstract

Despite various payment innovations, today, cash is still heavily used to pay for low-value purchases. This paper develops a simulation model to test whether standard implications of the theory on cash management and payment choices can explain the use of payment instruments by transaction size. In particular, using diary survey data from Canada, France, Germany and the Netherlands, we test the assumption that cash is still the most efficient payment instrument, and the idea that people hold cash for precautionary reasons when facing uncertainty about their future purchases. The results of the simulations show that these two factors are significant determinants of the high shares of low-value cash payments in Canada, France and Germany. Yet, they are not so crucial in the Netherlands, which exhibits a significant share of low-value card transactions. We discuss how the differences in payment markets across countries may explain the performance of the model.

A New Elementary Geometric Approach to Option Pricing Bounds in Discrete Time Models

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Abstract

The aim of this paper is to provide a new straightforward measure-free methodology based on a convex hulls to determine the no-arbitrage pricing bounds of an option (European or American). The pedagogical interest of our methodology is also briefly discussed. The central result, which is elementary, is presented for a one period model and is subsequently used for multiperiod models. It shows that a certain point, called the forward point, must lie inside a convex polygon. Multiperiod models are then considered and the pricing bounds of a put option (European and American) are explicitly computed. We then show that the barycentric coordinates of the forward point can be interpreted as a martingale pricing measure. An application is provided for the trinomial model where the pricing measure has a simple geometric interpretation in terms of areas of triangles. Finally, we consider the case of entropic barycentric coordinates in a multi assets framework.

A Model of Price Limits on Individual Stocks

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Abstract

We develop a model to demonstrate that price limits on an individual stock could advertently trigger speculation or even crash. Price limits themselves contain no economically meaningful new information to the market. Instead, as a public spectacle, price limits steer attention from investors who subsequently form a common belief. However erroneous the common belief is, when its believers act on it together, it becomes a self-fulfilling prophecy. The key insight is, when the price movements are legitimate adjustment toward the fundamental value, price limits can only delay price discovery. While price limits provide a brief moment for heated minds to cool off, it can potentially cause a bigger problem – the price-limit rule itself can create erroneous common belief, which sets off speculation and even possibly lead to crash. Our model explains the well-documented magnet effects and the asymmetric effects of price limits. The empirical evidence supports our model predictions and adds creditability to the model.

Disappointment Aversion in Asset Allocation

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Abstract

We investigate investors' asset allocation in a more generally applicable framework in which their utility consists of wealth utility and disappointment-elation utility. We show that optimal investment proportions in risky assets increase when disappointment aversion or risk aversion on the assets decreases and that disappointment aversion increases when expected excess returns increase. If decreasing absolute risk aversion holds, disappointment aversion increase with wealth, which is supported by our empirical results with asset allocation in pension funds of 35 OECD countries. We also find that individualism is positively related to disappointment aversion. These results indicate that the overconfidence represented by their individualism leads to more disappointment when losses occur.

It Ain´t Over Till It´s Over: Great 4 in The Way it All Began

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Abstract

Over the period 1980 through 2010, four relevant global phenomena have occurred (the Great 4), i.e., the Great Moderation, GreatDeviation, Great Leveraging and Great Recession. This study yields a global economy perspective on the latter phenoma, uncovering their interconnection, as well as contributing to the literature on the origin and end of the Great Moderation and the transition to the Great Recession. The paper also contributes to the literature on early warning indicators, assessing the information content of risk factor structuralinnovations for the prediction of the timing and depth of the economic downturn ensued by the subprime ?nancial crisis.

Mutual Funds Activity and Performance: Churn Rate versus Active Share

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Abstract

This paper discuss the active management in mutual funds and contribute to understand what is active management? Is it relation to performance? We present a comparison between two measures about active management: churn rate ante active share. With five years data about Brazilian fund´s portfolio between 2007 and 2011, we estimate a OLS model to relate active management and performance. While churn rate presents a negative relationship to performance, on the other hand active share have a positive correlation. We conclude that active management mutual fund´s managers may regard this finding when design strategies and internal directives to establish the ways to invest the client´s money.

Productive Efficiency of Argentine Banks

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Abstract

The goal of this paper is to estimate productive efficiency of banks in Argentina. For that purpose, panel data of the universe of banks under the supervision of Central Bank of Republic of Argentina (BCRA) is collected. In order to build bank´s indicators, a database of 66 institutions has been used, with annual information for the period 2009-2013. The source of information is both BCRA´s web site www.bcra.gov.ar, and Buenos Aires Stock Exchange´s web site www.bolsar.com. For this paper has been selected an efficiency indicator that may range between 0 and 1, meaning the lowest and highest level of efficiency, respectively. The concept of efficiency used in this paper is a relative one, because considers the performance of a Bank in respect to the behavior of the best players in the industry. The results show that mean efficiency of argentine banking is 0,8277. Berger and Humphrey (1997) found in american banking that average technical efficiency is about 0,79.

Relationship Between Working Capital Managemnt and Profitibility in Turkey Industrial Listed Companies

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Abstract

This study investigated the influence of working capital management component on corporate profitability. A sample of 106 firms listed on Borsa Istanbul Stock Exchange (BIST) for the periods 2003-2013 was used. The secondary data for analysis is taken from Bloomberg's Database. The study aims to explore the influence of working capital management components on corporate profitability. We observed that there is a negative relationship between gross operating profit and accounts receivables. We also find there is a positive relationship between gross operating profit and number of days inventory. But they are not significantly impacting the profitability of firms in the study.

Sufficient Diversification: How Many Shares are Required on Selected African Stock Exchanges?

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Abstract

Although African stock markets are increasingly opening up to international investors, they remain relatively under-researched compared to most other stock markets. This study investigates the number of shares required to hold a diversified portfolio on the Johannesburg Stock Exchange (JSE), the Stock Exchange of Mauritius (SEM), and the Casablanca Stock Exchange (XCAS), using standard deviation as a measure of total portfolio risk. For each of these markets R2-regression statistics are then used as an alternative measurement of firm-specific risk reduction with increasing portfolio size. We find that the standard deviation methodology indicates adequate diversification at 30 stocks for the JSE's Top100 index and the XCAS, but 50 stocks for the SEM. The linear regression methodology gives inconclusive results for the XCAS and SEM, whilst 40 stocks are required to hold an adequately diversified portfolio on the JSE's Top100 index. The latter result is consistent with a prior international study, which also found that the R2-methodology indicates a higher number of stocks required for diversification than the standard deviation measure. To our knowledge the linear regression analysis methodology has not been applied to any African stock exchanges prior to this study, and as such this study provides new insights into the diversification characteristics of three typical African exchanges.

Econometric Modeling of Asymmetry of Information (Bid-Ask), Corporate Governance Quality and Risk: Evidence from an Emerging Market

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Abstract

This study belongs to a stream of research developed that seeks to explain the relationship between the quality of corporate governance and information asymmetry in the Chilean Capital Market. Thus, the aim of this paper is to continue observing the relationship between asymmetry of information, measured by the spread (bid-ask) calculated from intraday data, and the quality of corporate governance, measured by an Index, incorporating in this study measure of total and unsystematic risk. It is expected that the spread should narrowed as the quality of corporate governance increase and will widen as the risk increase.

The Control of Model Price Acceptability Under the Univariate Vasicek Model

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Abstract

In this paper, we focus on the valuation of the probability of a fi nancial contract to be lower or higher of a given price under the univariate Vasicek model. This price restriction can be justi ed by consistency reasons, since they are not coherent on a nancial point of view, e.g. negative yield, or thought as unreachable by the asset manager. At fi rst, the constraints are formulated in terms of a bound on the current value of the spot rate process or, equivalently, in terms of a limit of the Gaussian increments driving the path of the process. Moreover, the short rate can be generated under the risk-neutral measure (for pricing purposes) or under the historical measure (for risk-management tasks). Once the bounds are identi fied, the probability of satisfying the restriction after the generation of the spot rate at one future date can be obtained. These results are extended to the generation of several prices comparing the corresponding levels of the barrier. Next, assuming that the bounds on the spot rate are constant during a Monte-Carlo simulation, the probability of generating a path of the spot rate that does not satisfy the constraint is valued using some approximations related to the stopping times. Again, these results are extended for the generation of several prices comparing the barriers. Lastly, the approach is applied to several market prices and is illustrated by some numerical examples.

Detecting Speculative Bubbles in the Mexican Stock Market

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Abstract

Financial asset prices often reflect behaviors that do not respond to fundamental elements; instead, they seem to be composed of explosive factors that favor excessive increase in market prices. Similarly, strong speculation that stimulates non-fundamental investment is a characteristic that leads to the formation of speculative bubbles. These bubbles, which are defined as a disproportionate growth of the differences between the market value and the book value of assets, generate excessive overvaluation that damages the market and the economy, as they create a false illusion of wealth. However, the severity of this phenomenon is that this behavior may face an unexpected setback in the trend, causing big losses for investors, panic in financial markets and a potential crisis for the economy. The benefit of this research lies in the possibility of identifying the time in which excessive valuation is present in the Mexican Stock Market so the Mexican Central Bank can conduct a further analysis and decide if corrective policies are needed.

Islamic Finance and Internationalisation Trends: Prospects and Challenges

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Abstract

Islamic banking has developed immensely and has gained global acceptance. From a local system of finance with limited assets and market shares, Islamic banking now emerges as a multinational industry. Many viewed that the emergence of Islamic finance as a system of thought and practice is timely in the midst of world crisis and the uncertain proposals for solving it. Islamic finance is now in the stage of internationalization to be integrated in the global financial system. While the prospect for Islamic banking growth continuous to be positive, the challenges faced and the opportunity to offer a new financial approach and hence regulation in the international financial landscape is very much awaited. Islamic finance has not only demonstrated its viability and competitiveness in the current environment of a more liberalized and globalized financial system with changing business and technological climates, but now, it is also in the move towards integration into global financial market. The paper attempts to observe the development of Islamic finance worldwide by looking at the history, trends and prospects. The paper also discusses some challenges faced by Islamic financial industry for future progress and development.

Institutional Monitoring, Political Connection and the Cost of Debt: Some Evidences from Malaysia

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Abstract

In this paper, we examine the main and joint effects of institutional monitoring and politically connected (PCON) firms on the cost of debt. Based on a sample of 1,565 firm-year observations for the period 2005-2010, we provide evidence that (1) institutional ownership (IO) is associated with lower cost of debt, and (2) institutional ownership attenuates the positive association between PCON firms and the cost of debt. When we split IO into local and foreign institutional investors, we find that it is the local IO, and not foreign IO that leads to lower cost of debt and attenuates the association between PCON firms and the cost of debt. Overall, our results suggest that IO, particularly local IOs, can alleviate agency problems in PCON firms through active monitoring and contributes to a better understanding of the monitoring role of institutional investors in Malaysian firms.

Institutional Investors and Firm Valuation: Evidence from Latin America

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Abstract

This document evaluates the effect that has the presence of an institutional investor as a shareholder on the corporate valuation of Latin American firms. The study is made with a data set of 562 firms from six Latin American countries for the period 1997-2011. As similar studies, we found that the presence of an institutional investor has a positive effect of 7.6% on firm value. After dividing the sample by type of investor, we found that the presence of a Grey Investor (Pension funds and insurance companies) have a negative effect on firm valuation, while Independent Investors (Banks, investment and mutual funds) have a positive effect on firm valuation. This is one of the first studies to evaluate the relationship between investor activism and corporate valuation within the most important economies of the Latin American region, in terms of their capital markets development.

Incidence of Corporate Income Tax and Optimal Capital Structure: A Dynamic Analysis

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Abstract

In this paper, we analyze the incidence of corporate income tax using a dynamic general equilibrium model. By building a dynamic macroeconomic model, it is able to analyze not only the instantaneous incidence of corporate income tax but also consider the intertemporal incidence. The dynamic model in this paper includes capital structure, that is, choice of equity, debt, and retained earnings to implement investment. It also includes agency cost on debt: per unit of agency cost on debt is progressively-increasing. We implement a simulation based on the dynamic model, and measure the incidence of corporate income tax on labor income. We found that a percentage of the incidence on labor income is about 50-80% in the short run (for one year), and a percentage of the incidence on capital income is about 20-50%. In the long run, about 95% of the incidence is on labor income. Almost all of the incidence is shifted to labor income, but not all of the incidence is. In contrast, in a neo-classical growth model, the entire incidence is shifted to labor income in the long run. The result of this paper seems to be caused by the agency cost on debt.

R&D Management during Initial Public Offerings

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Abstract

In this paper we demonstrate that IPO firms engage in real activities manipulation during the initial public offerings (IPO). Specifically, we study an important component of real activities manipulation: investments in research and development (R&D). We find both types of R&D manipulation during the IPO: R&D under- and over-investments. R&D underinvestment (i.e., earnings management) is present mostly for firms that would report losses in the absence of R&D management and firms with reduced accruals management flexibility. R&D overinvestment (i.e., R&D management) is present mostly for young, unprofitable, science-based firms, and for firms with zero sales. We show that firms overinvesting in R&D have more severe decline in post-IPO performance than firms underinvesting in R&D. Future performance analysis reveals that firms overinvesting in R&D experience significant long-term operating underperformance, lower future innovation quality, higher rate of delisting due to poor performance, higher abnormal volume and lower abnormal stock return around the unlock date.

Optimal Margin Levels under Extreme Fluctuations in Chinese Gold Futures Market

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Abstract

The static level of futures margins in China is presently only an empirical figure, and it is not sensitive to price fluctuations. Sometimes, these margins levels cannot cover the risk enough when the market fluctuates severely. In this study, with the total sample from January 9, 2008 to July18, 2014 and subsample of financial crisis from SHFE, the POT and Expected Shortfall methods are used to study the gold futures trading margins; the Return Level which is based on the BMM method is used to study the clearing margin. Results show the optimal trading margins are lower than the present margin level, 3.9% is suggested for the ordinary margin level and 5.36% is suggested for the prudent margin level when the risk increases. It is suggested that the clearing margin should be changed from 5% to 5.72% to cover risks from six months to one year.

Pricing and hedging variable annuities in a Lévy market A risk management perspective

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Abstract

The aim of this paper is to price, to hedge and manage particular life insurance contracts with guarantee. The market of such contracts known as Variable Annuities or Equity Indexed Annuities is a huge market. We use the same methodology for pricing and hedging these products. The hedging of these contracts is a challenge for both insurers and academics. In this paper we suggest a solution which is operational and efficient. To be more realistic we model financial prices by Lévy processes. We emphasize the fact that not taking flat tails of financial returns into account can lead to hedging errors with severe consequences.

Equilibrium Bid-Ask Spread of European Derivatives in Dry Markets

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Abstract

Abstract We characterize how equilibrium bid-ask spreads of European derivatives arise in the framework of incomplete markets. We model incompleteness as generated by the non-trade of the underlying asset at some points in time. Using partial equilibrium analysis, we show the following results. For monopolistic, risk-neutral market-makers we fully characterize the bid-ask spread within the no-arbitrage bounds. For oligopolistic, risk-neutral market-makers we prove that equilibrium bid-ask spread cannot exist. We are thus led to conclude that under market competition, market-makers must present some level of risk aversion in order to generate an equilibrium bid-ask spread.

The Influence of Informational Asymmetry in the Capital Structure of Brazilian Companies: An Analysis of Bovespa's Special Segments

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Abstract

Based on the theory of Pecking Order, the aim of this study is to analyze the influence of informational asymmetry in the capital structure of the companies that comprise the special segments of São Paulo Stock Exchange (Bovespa), created in 2001 with the aim of distinguishing the companies by the compliance with corporate rules, as well as companies that comprise the Traditional Group. To achieve the aim, the methodology of panel data analysis has been used, which has allowed the analysis of the influence of control variables, proxies and dummies related to informational asymmetry in the indebtedness of companies in the special segments: New Market, Levels 2 and 1 of Corporate Governance, and Traditional Group. Therefore, the analysis was carried out in two periods: P2, (2001 to 2013) and P1 (2007 to 2013). The results demonstrated that in companies, which have adhered the segments of Bovespa, the indebtedness has been used in a lesser extent, furthermore, the proxies related to informational asymmetry have shown negative signals and statistically significance in the segments in which the diffusion of information is more rigid, New Market and Level 2 of Corporate Governance.

Commodity Futures price under a co-integrated Gibson-Schwartz model

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Abstract

Co-integration relationships among commodities are well established in various econometric studies. However their applications in derivatives pricing and risk-management remain to be challenging. Nakajima and Ohashi (2012) have been derived futures and call option prices under a cointegration version of the famous Gibson-Schwartz model. It arises that the prices under co-integration are actually given by very long formulas and involve technical and arduous computations. Our purpose in this work is to revisit the price of futures contract obtained by these two authors, with three main objectives: 1) to provide a price with an easily understandable statement form, 2)to perform very detailed proof, ensuring the result to be less error prone,3)to implement the corresponding R-code, allowing the reader to benefit directly from the pricing formula. The form of price derived in this work has also the power to be workable for further explorations as in commodity portfolio risk measurement and hedging.

Natural Experiments in Derivatives Market

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Abstract

The major factors affecting the volume of futures and options in any country are deemed to be the contract size, volatility, taxation and margin requirements. Contract size change have been shown to affect the liquidity of the product in prior studies. In India, contract changes have significant effect on volumes and the same is true in the case of South Korea however, Australian markets have shown insignificant impact to contract changes in value terms. In India, the total trading volume of the derivatives as a whole also increased in the same period which also coincides with the beginning of the financial crisis. In Australia, along with contract size reduction, transaction cost is also reduced and resulted in increased trading volumes but in value terms no significant increase in trading. In South Korea, transaction costs were kept unchanged and volumes had declined due to increase in the size of the contract.

The PR Premium

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Abstract

Press Release(s) (PRs) are the most common and popular way for a firm to publicize its news. The annual number of PR varies substantially among firms, from just a few to hundreds. This work documents a gap in stock's returns between firms that publish low and high number of PR per annum in favor of the former. This gap was found for both the year of publication and the following one and its magnitude is 7%-8% and 5%-6% respectively. This gap remains intact even after controlling for firm characteristics such as beta, market capitalization and more. I call this gap the "PR Premium".

Financial Literacy In A South African Context

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Abstract

Currently there is no uniform measure of financial literacy which calls into question the reliability and comparability of results from existing studies. To measure an individual's financial literacy level one would first need to define financial literacy. However, no standard definition currently exists and studies in South Africa have adopted definitions from developed countries. The aim of this research was to determine what financial literacy entails in a South African context. This was achieved through establishing the perceptions of financial services experts in Gauteng regarding the definition of financial literacy, financial literacy levels, and factors affecting financial literacy. The research findings indicate that the rural/urban split is a significant factor affecting an individual's financial literacy, and that financial literacy is a multi-level standard that is relative to an individual's personal circumstances which indicates that a standard definition is inappropriate. Suggestions are made for what a measuring instrument should encompass.

HETEROGENEOUS EXPECTATIONS AND FINANCIAL EQUILIBRIUM: Comparative Statics Analyses

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Abstract

The paper uses a two-state, complete markets model to study securities price equilibria when investors have heterogeneous expectations. Using relatively minimal restrictions, the paper identifies several distinct comparative statics effects. First, it shows that price and quantity data distinguish the impacts of changing expectations from changing investment opportunities. Second, it shows that capital formation and credit granting decisions also have distinct, identifiable impacts. The paper uses a probability function shift to reflect unanimous change in expectations, a rotation to represent increasing disagreement. A shift - unanimous agreement regarding a potential increase in an upstate probability - is sufficient for both the upstate claim price ratio and the proportion of upstate claim purchasers to rise together. (The effect is symmetric: unanimous agreement regarding a decrease lowers both ratios.) Unanimity is necessary as well as sufficient: in its absence the foregoing results can be contradicted. The impacts of a rotation depend on its direction and locus relative to the original equilibrium. All logically possible outcomes can be characterized using these variables – including the absence of any effect if the locus of rotation coincides with the original marginal investor's position. The paper also identifies capital formation and credit availability effects. If capital formation increases the upstate asset payoff, the claim price ratio decreases but the proportion of optimistic buyers increases. (An increase in the downstate payoff has opposite impacts.) If optimists can borrow they will bid up the equilibrium claim price ratio, but relatively fewer of them will buy at the higher price. (The impacts are reversed if optimists repay previous borrowings.) We also measure equilibrium market risk in comparison to its value in a homogeneous expectations economy. A comparison portfolio's risk premium, return volatility and Sharpe ratio all increase as the heterogeneous equilibrium claim price ratio deviates in either direction from the comparison standard. Hence the impacts once again depend on relations between the original and new equilibria.

Cash versus card: the role of budget control

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Abstract

Abstract Due to the financial crisis, an increasing number of households face financial problems. This may lead to an increasing need for monitoring spending and budgets. We demonstrate that both cash and the debit card are perceived as helpful in this respect. We show that, on average, consumers responsible for the financial decision making within a household find the debit card more useful for monitoring their household finances than cash. Individuals differ in major respects, however. In particular, low earners and the liquidity-constrained prefer cash as a monitoring and budgeting tool. Finally, we present evidence that at an aggregated level, such preferences strongly affect consumer payment behavior. We suggest that the substitution of cash by cards may slow down because of the financial crisis. Also, we show that cash still brings benefits that electronic alternatives have been unable to match. This suggests that inclusion of enhanced budgeting and monitoring features in electronic payment instruments may encourage consumers to use them more frequently.

Financialization of metal commodity markets: Does futures trading influence spot prices and volatility?

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Abstract

The emerging financialization of commodity markets over the last decades has lead to an intense public and scientific debate about commodity investing and its implications. Although metal commodities are indispensable to economy and industry, the influence of financialization on metal spot prices and in particular on respective volatility has been insufficiently studied. There-fore, we attempt to contribute to existing literature by examining potential effects of the lead-lag relationship on futures trading activity of commercial and non-commercial market participants and cash prices and volatility for the major metal commodities: copper, gold, silver, platinum and palladium. Analyzing Commitment of Traders (COT) reports from the U.S. Commodity Futures Trading Commission (CFTC) over a timeframe from January 1993 to December 2013, bi-directional Granger-causality tests show that there is hardly any influence of trading activity driving metal spot prices in the long-term, but volatility to some extent. We find indications of price and volatility influencing effects of trading activity within sub-samples, such as phases of booms and crises. Contrary to public perception, commercial and long positions affect price levels and volatility far more than activities of non-commercial traders. However, for the reverse direction there is strong evidence that commodity prices and volatility drive trading positions.

Two Shades of Opacity: Hidden Orders versus Dark Trading

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Abstract

Today traders are faced with an increasing number of possibilities to hide their trading intentions. In general these options can be classified into two broad categories: (1) hidden orders on otherwise lit trading venues, and (2) completely dark trading venues. Our paper investigates the relation between both types of opaque trading. Using a detailed high-frequency dataset, we first show that hidden and dark trading are substitutes: an increase in hidden order trading implies reduced dark trading and vice versa. Second, we show that volatility and imbalanced trading drive the segmentation of trading activity into a visible and an opaque part. Third, we identify market quality variables (spread and visible depth) that drive opaque trading activity either to hidden orders on lit venues or to dark trading venues. Finally, we document a strong positive relation between the fraction of hidden order trading on several alternative lit trading venues.

Portfolio Turbulence and the Predictability of Stock Returns

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Abstract

This paper investigates the predictive power of portfolio turbulence for future market and portfolio (excess) returns. Results are related to return dispersion and the realized stock market variance, two other well-documented predictive variables. We find portfolio turbulence to have the higher predictive power for long-term forecasts of market (excess) returns in-sample as well as out-of-sample. Portfolio turbulence also has out-of-sample predictive power for long-term portfolio (excess) returns for value and large cap stocks, as well as for past losers.

Employment Protection Legislation and Corporate Financing Decisions

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Abstract

This study examines the effect of employment protection legislation (EPL) on the capital structure decisions of firms. We argue that firms take on less debt in a strict EPL environment because of higher financial distress costs and a higher operational leverage. Instead of having to rely on country specific proxies for EPL as is common in the literature, we compute several company specific measures of a firm's exposure to EPL using a panel dataset of 14,691 Belgian small and medium-sized firms between 2000 and 2012. The construction of such measures is possible as all Belgian firms have to publish financial data as well as detailed information on their work force composition. Our empirical results not only show that the leverage ratio of firms is lower when they are exposed to stricter employment protection rules. They also indicate that firms are less likely to adjust leverage levels upwards or downwards when they are legally obliged to fulfill more employment protection obligations.

ASSET PRICING AND ENERGY CONSUMPTION RISK

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Abstract

This paper proposes the growth rate of energy consumption as a new proxy for the consumption factor in testing the consumption-based capital asset pricing model (CCAPM). Based on a sample of US data, we find that (i) the energy consumption factor implies a reasonable value of 2 for the relative risk aversion, (ii) energy consumption risk successfully explains the cross-sectional variation in excess returns, (iii) energy consumption risk is priced in the Fama and French (1993) and Carhart (1997) models and (iv) energy consumption in the industrial and commercial sectors better capture time-series and cross-sectional return variation than aggregate total energy consumption.

Interactions in Connected Money Markets Collateralized vs Unsecured Funding

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Abstract

We present a money market model of interactions between unsecured and collateralized funding. Interest rates and volumes are determined in equilibrium and driven by differences in costs in each funding segment and liquidity shocks. Using a novel dataset of interbank transactions, we perform an empirical analysis through a structural model, and we estimate measures of risk perception and liquidity stress based on the interaction of unsecured/secured money markets for the Euro Area. These measures have a significant predictive power for interest rates as our equilibrium model predicts. Our findings suggest that useful information is contained in money market interactions.

The Financial Crisis and the Macro-Determinants of Corporate Bond Credit Spreads

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Abstract

We construct a unique data set of three investment-grade and three high-yield corporate bond portfolios with daily rebalanced weighted-average maturities of 6, 10, and 15 years. By working with portfolios, we mitigate the effects of event and the liquidity risks of individual bonds. This allows us to focus on the macro-determinants of credit spreads, after controlling for credit quality and maturity. Three types of macro-determinants are examined: (a) term structure level and slope, (b) stock market return and volatility, and (c) bond market volatility and liquidity. In theory, macro-determinants of credit spreads are predictors of future default probabilities and are associated with credit risk premiums. A Markov-switching model results confirms the presence of two regimes. Bond index volatility is the most significant determinant of the probability of switching from one regime to another.

A New Perspective on the International Evidence Concerning the Book-Price Effect

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Abstract

Finance theory implies equity returns should be positively related to financial leverage. However, when Penman, Richardson, and Tuna (2007) decomposed the book-price ratio into financing and operating components, they report that financial leverage may actually be negatively related to returns for stocks listed in the USA. In this paper we show that the relationship between equity returns and financial leverage is positive for stocks listed in the new EU members. This leaves us with the puzzling question of why stocks listed in different regions should exhibit different relationships with financial leverage. We explain this result by country-specific factors determining capital structure causing investors to perceive the risks associated with financial leverage differently depending on the characteristics of the region in which the stock is listed and this is reflected in the decomposed book-price ratio.

Stock Price Informativeness and Output Growth: Some Evidence from Emerging Economies

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Abstract

This paper extends the output growth model tested by Levine and Zervos (1998) by including a measure for capital allocation efficiency proxied by stock price informativeness. Using a sample of 62 countries, this study finds that stock price informativeness as measured by firm-specific return variation positively contributes to output growth after controlling for variables in the Levine and Zervos (1998) model.This effect is particularly strong for high property rights protection environments and common law countries in emerging economies. We find that stock price informativeness acts as a substitute for stock market liquidity on predicting long-run output growth in emerging economies but not in more developed economies. These results are consistent with the Roll's (1988) claim: more information-laden stock prices signal efficient stock markets and, therefore, stronger output growth.

Properties of the Financial Break-Even Point in a Simple Investment Project as a Function of the Discount Rate

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Abstract

We consider a simple investment project with the following parameters: I>0: Initial outlay which is amortizable in n years; n: Number of years of the duration of the investment project which makes the same activities per year with only one product; A>0: Annual amortization (A=I/n); Q>0: Quantity of products sold per year; Cv>0: Variable cost per unit; p>0: Price per unit with p>Cv; Cf>0: Annual fixed costs; te: Tax of earnings; r: Annual discount rate. We also assume that the annual inflation is depreciable. We obtain the explicit expression of the net present value (NPV) of the investment project as a function of the independent variable Q and we get the explicit expression of the financial break-even point Qf (i.e. the investment project has a NPV of zero) as a function of the parameters I, n, Cv, Cf, te, r, p. We study the behavior of Qf with respect of the discount rate r and we prove that: (i) When r is depreciable Qf goes to the accounting break-even point Qc (i.e. the investment project has the earnings before taxes (EBT) of zero); (ii) When r is large the graph of the function Qf=Qf(r) has an asymptotic straight line with positive slope. Moreover, Qf(r) is an strictly increasing and convex function of the variable r; (iii) By a sensibility analysis we obtain that p and Cv have an appreciable influence on Qf, and Cf has a depreciable influence on Qf; (iv) Moreover, if we assume that the investment project is also growing at the rate g per year then we obtain the same results as before but the graph of the function Qf=Qf(r,g) vs r has, for all g>0, the same asymptotic straight line when r goes to infinity as the particular case with g=0.

Bankruptcy Prediction for U.S. Banks

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Abstract

We examine the bankruptcy of 132 U.S. banks over the 2002 to 2009 period using multivariate discriminant analysis (MDA) to attempt to predict banks that would fail. Our model uses variables that measure general financial health, loan reliance, funding of loans, loan quality, capital adequacy, and reliance on off-balance sheet items. Our in-sample results suggest that we are able to successfully distinguish between banks that would fail and those that wouldn't 92% of the time using quarterly data, while the most important variables are related to bank profitability, capital adequacy and loan quality. More importantly, our model does an excellent of distinguishing healthy banks from those that are at high risk of failure. "Out-of-sample" application of our model during 2010-11 produces excellent results - predicting banks that would fail 89.5% to 95.8% of the time, depending on the chosen application of the model. This type of "out-of-sample" success far exceeds the success of most financial models and illustrates why our model represents such an important contribution. While a statistical model such as ours is no substitute for "on-site" examinations and detailed examination of asset quality, it does represent an effective supplement to them. In particular, since we are able to effectively classify a large number of firms, it can be used to identify those banks that should be scrutinized in more detail, and hence make use of more detailed qualitative information. Such a model will be of obvious interest to banks' internal risk management, to regulators, as well as to others with a direct interest in assessing bank financial health such as analysts, fund managers, and financial transaction counter-parties.

Generation of scenarios for the interest rates under the Arbitrage Free Dynamic Nelson-Siegelmodel

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Abstract

The affine Arbitrage-Free Dynamic Nelson-Siegel(AFDNS)model introduced by Christensen,Diebold and Rudebusch (2007)provides a new interesting alternative framework for pricing and risk managing, as it both maintains the theoretical arbitrage-free restrictions of affine models and provides remarkably empirical properties. Our purpose in this paper is to perform the analyzes and formulas to apply when generating scenarios for the interest rate at a future time-horizon under the above mentioned model. To allow the reader to fully benefit from our findings, the corresponding R codes are included here

Redemption Fees: Reward for Punishment

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Abstract

Short-term redemption fees have become increasingly prevalent amongst mutual funds. Mutual funds impose redemption fees with the intent of maximizing the wealth of mutual fund shareholders through discouraging them from engaging in frequent trading activity. This paper empirically analyzes if and how redemption fees achieve this goal. We find that mutual funds with redemption fees outperform their counterparts by 1.0 to 1.4 percent a year. Moreover, performance increases by 0.5 to 2.4 percentage points a year following the initiation of a redemption fee such that the difference in performance between the two groups of funds is indeed attributable to the fee. We find that the fee improves performance through changing portfolio characteristics. Most notably cash holdings decrease by 77 to 102 basis points after fee initiation.

Labor Market Reforms and Current Account Imbalances: Beggar-Thy-Neighbor Policies in a Currency Union?

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Abstract

Member countries of the European Monetary Union (EMU) initiated wide-ranging labor market reforms in the last decade. This process is ongoing as countries that are faced with serious competitiveness within a currency union. This fosters fears among observers about a beggar-thy-neighbor policy that leaves non-reforming countries with a loss in competitiveness and an increase in foreign debt. Using a two-country, two-sector search and matching DSGE model, we analyze the impact of labor market reforms on the transmission of macroeconomic shocks in both, non-reforming and reforming countries. By analyzing the impact of reforms on foreign debt, we contribute to the debate on whether labor market reforms increase or reduce current account imbalances.

The Role Of Private Credits To Finance Women's Self-Employment : Evidence from Latin American Integration Association-LAIA

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The current study aims to address the factors related to female self-employment both theoretically and empirically. The relationship between private credits, income level, labor force participation rate and female self-employment was analyzed by means of using panel data method for the countries constituting Latin American Integration Association (LAIA). A significant relationship was found between the relevant variables in the study which covers the years of 1990-2012 and in which Panel Cointegration and Granger causality tests were performed. While there is a negative relationship between GDP (gross domestic product) per capita and self-employment, it was found that an increase in the private credits and female labor force participation rate has a positive impact on female self-employment.

Autocorrelation in the global stochastic trend: Does it help to forecast market returns?

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Abstract

In this paper a Kalman-filter type model is used to extract a global stochastic trend from discrete non-synchronous data on daily stock market index returns from different markets. The model allow for the autocorrelation in the global stochastic trend, which means that its increments are predictable. It does not necessarily mean the predictability of market returns, since the global trend is unobservable. The performance of the model for the forecast of market returns is explored for three markets: Japan, UK, US.

The New Audit Report Seen Through the Prism of The Ceretified Auditors – Research in The Republic of Macedonia

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Abstract

With recomposing of the audit report, IAASB announce the commencement of the new era in the audit profession. The proposed amendments in ISA 700, 705 and 706, as well as the new ISA 701 are expected to decrease the information gap and in the same time to increase the communication power of the audit report. The new look of the audit report should meet the users' requirements for obtaining more information tailored to the specific audit of financial statements engagement. The revision of the standards related to the audit report and their publication in June 2014 encouraged us to carry out a research that will include the certified auditors in the Republic of Macedonia. The main objective of the research is to realize the perception the certified auditors have regarding the new amendments and whether they really expect an increase of the credibility of the audit report in the users' eyes which will decrease the "expectation gap". The paper is consisted of three parts. The first one is focused on the historical background of the statutory audit in the Republic of Macedonia. The second part defines the objective of the research and the related to it the questionnaire development and sample selection. In the third part are summarized the results of the conducted research and based on it are suggested alternative directions for future researches.

Potential Impact of the Basel III Accord on the demand for mortgages-The case of Netherlands

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Abstract

The financial crisis of 2007 led to many problems within the financial system. Many financial institutions went bankrupt and others were saved by a government intervention. Many households are still facing financial problems. Due to the financial crisis the Basel III Accord are formulated and builds on Basel II. The regulations of Basel III will have their impact on many subjects. One of these subjects is mortgages. This study examines the impact of an increase of the buffer, held by banks when offering a mortgage, on the demand for mortgages. The relation between leverage ratios, interest rates and demand for mortgages is examined. Given two different periods (annually and monthly), four different maturities for interest rates and a fixed decline of leverage ratio, there are different outcomes interpreted. Using random walk with a drift and rolling window, forecast is made for interest rates. Based on the forecasted interest rates, the demand for mortgages is examined. Findings of this study support the hypothesis that an increase of the buffer will result in decreasing demand for mortgages on annual and monthly basis.

A Microstructure Approach to Gross Portfolio Inflows: the Case of Chile

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Abstract

In this paper we explore the determinants of portfolio gross inflows (foreign liabilities) to the Chilean economy in dimensions that are novel to the literature, by using a unique dataset proprietary to the Central Bank of Chile, that records each and every transaction of foreign investors on portfolio instruments. We analyze aggregated gross inflows, and also inward and outward components of these gross inflows separately, finding that inward, and not outward, flows are those that respond to the traditional push/pull factors. Depending on the type of investor, the significance and economic relevance of each determinant varies: In summary, when analyzing the determinants of inflows, the results of independent regressions by type of investor, corroborate the results of IMF (2014): institutional investors and non-indexed funds are more sensitive to external factors such as the VIX, although the latter -mostly mutual funds- react relatively less. These two type of investors, in fact, are not signi cantly determined by domestic output surprises, being sovereign funds and investment banks, followed by indexed funds the ones that increase the most their investments in Chile in response to a positive surprise. Sovereign funds are the ones who respond the most differently. They are the only ones for which pull factors such as the reserve coverage ratio and the short-term interest rate differentials are significant. Finally, depreciation expectations are relevant for institutional investors, as well as indexed and sovereign funds. Case studies around two volatility events (March 1999 and May 2013) suggest that, when foreign capital outflows are observed, they can be either due to investor decisions to invest less (decrease inward flows), to repatriate their investment (increase outward flows), or both. Disregarding these two different decisions can mislead its implications.

All Taste Valuation

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Abstract

This article develops a set of valuation equations that allows for tax shields other than debt. Free cash flows, equity cash flows and capital cash flows are used to value operations. The residual income for the three measures is also derived and valued. Both types of cash flows are further modified to discount at the unlevered rate, shedding light upon the additional risk imposed on those cash flows by financial decisions. A numerical example for finite and perpetual growth cash flows demonstrates the consistency of the method.

Does Financial Development Promote Innovation In Developing Economies? An Empirical Analysis

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Abstract

In this paper we use firm-level data from 2006 to 2013 to examine the effect of financial development on innovation in developing countries. Given that literature is not yet conclusive on the topic, first because the precise channel through which financial development affects growth is not clear, and second because current studies do not differentiate the effect of financial development on growth, conditional on the stage of economic development, then focusing on developing countries enables us to understand the channel-innovation and the differentiated effects of financial development on growth. We find a robust but puzzling result, since in developing countries, contrary to most literature, financial development has a negative effect on the probability of a firm to innovate, but it increases as the firms grows. These results are robust for different measures of financial development. In line with Tadesse (2005 & 2006) and Yan, Hsu, & Tian (2014) we argue that this is a result of the design of the financial system, the lack of capital and the institutional system. Consequently, these countries should first generate appropiate insitutional conditions if they want financial development to spur growth via innovation.

Consequences of Mandated Bank Liquidity Disclosures

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Abstract

This paper studies the capital market consequences of unique and unexpected mandatory disclosures of banks' liquidity and the resulting changes in banks' behavior. I employ a hand-collected sample of the disclosures of banks' borrowing from the US Federal Reserve Discount Window (DW) during the financial crisis. I find that these disclosures contain positive incremental market information as they decrease banks' cost of capital (measured by the equity bid-ask spreads and the cost of debt). However, I also find evidence of endogenous costs associated with more disclosure. I document that banks respond to the DW disclosures by increasing their liquidity holdings and decreasing risky assets. In line with the theoretical predictions of Goldstein and Sapra (2013), this finding indicates that, following the DW disclosures, banks try to avoid accessing the DW facility, despite its cost of capital benefits.

Corporate Governance, Gender and Cost of Debt in Argentinean SMEs

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Abstract

The aim of this paper is twofold. In first place, we study the characteristics of the corporate governance (CG) of small and medium enterprises (SMEs) that are issuers of corporate bonds in Argentinean Securitites Exchange markets. Second, we analyze the relation between GC characteristics, gender, and the cost of debt issues. We find that internal CG mechanisms, such as ownership concentration, outside board members, and a female auditor significantly affect the cost of debt. Morever, economics groups, which are an informal institution related to CG, also have a relevant effect.

Bank Bailouts in Europe 2007-2013: What Characterises Banks Before and After Rescue?

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Abstract

With the start of the financial crisis, many European governments have put together emergency rescue packages to support struggling banks. More than 110 banks benefitted from government support in Europe during the years 2007 until 2013. In this paper, we investigate the overall condition of banks before and after they received state support. More precisely, we are interested in the differences between banks that asked for support and those that came through the crisis without any aid, before and after government intervention. Our results indicate that the simple equity ratio, measured as total equity to total assets, is the decisive indicator throughout the years. The equity ratio performs better than the risk-weighted core tier 1 ratio in differentiating between aided and non-aided banks. Surprisingly, the aided banks hardly improve their equity ratio after they've been rescued but continue with a similar risk profile/business model. The macro-economic environment is also key to bank performance, before and after the interventions.

Correlations between the state ownership and the profit margin, the ability for mergers and acquisitions and the investment willingness in the telecommunications industry

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Abstract

The telecommunications industry is a complex matrix with networks, telephones, mobile phones and internet-linked PCs; the global system touches nearly all of us. Therefore the industry has a strategic importance for every country. From Norway to Japan, from Malaysia to the Netherlands, many countries think to have some or more ownership in companies operating in these segments is crucial. Other countries' vision is a fully liberalized market, where strict regulation helps to keep the control such as in the US, in the UK or in Australia. Which is better? Having state owned (or partially owned) enterprises (SOE) or leave the state should opt out from the segment? Is there any benefit for companies which have state ownership? For example in a situation of a M&A? Or does the state ownership in the telecommunications industry determine the investment willingness?

Business are Just Business? Ethics in Action.

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Abstract

This paper presents an experimental design to study how the ethics and the perception of risk involved in decision-making of investment from individuals. The study is presented from the perspective of behavioral economics where the influence of behavior and cognitive aspects of the individuals who make decisions in this market are taken into account. The interest of the study is to measure the influence of ethics and the risk perception in decision making, it is carried out using an instrument that was applied to university students in undergraduate and postgraduate programs, professionals from various sectors as well as professionals of the financial sector. The results indicate that ethics has effects on investment decisions.

Controversial industries produce a better ESG performance: Evidence from emerging markets

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Abstract

We investigated whether the financial profile of the firm induces superior performance strategies in corporate social responsibility (ESG), measured using four different proxies, which are the component parts of the integrated performance structure of the company. To do so we considered data from 365 listed companies between 2010 and 2012 in emerging markets, known as the BRICS. The main results suggest that companies in industries that are more likely to cause social and environmental damage seem to have a superior performance in environmental issues, in corporate governance and in the social area, even when variables for the firm's size and country where listed are controlled.

Understanding Risk Tolerance: The Proposal of a Multinomial Logit model

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Abstract

The objective of this study was to identify the influence of Financial Behavior and profile variables in Risk Tolerance. To achieve it, 2.485 individuals from the Central Western Mesoregion of Rio Grande do Sul were studied. Descriptive statistics, confirmatory factorial analysis and a multinomial logit regression have been applied. The main results show that the sample is heterogeneous and in average, people interviewed are not tolerant to risk, they worry about saving money and manage their finance in an adequate way. In relation to Risk Tolerance determinants, it has been identified that individuals with more severe financing control and low predisposition to save are risk averse. Moreover, male individuals, married, without dependents, with stability related to work, younger, with low level of schooling and higher income have the highest probability to take risk

Volatility Spillovers and Dynamic Correlations Among Foreign Exchange and Bond Markets of the Emerging Economies

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Abstract

The global financial crisis reached its peak when Lehman Brothers declared its bankruptcy on 15th of September, 2008. To avoid the risk of a financial collapse, the Fed has taken steps to launch several quantitative easing (QE) programs. The Fed's first exit signal from these QE programs was given by Chairman Bernanke on 22nd of May, 2013 during a Congress hearing. Eventually, the Fed announced its tapering decision on 18th of December, 2013. These historical shocks (events and central banks' decisions) are well known to have had huge impact on the foreign exchange, money and credit markets, especially in such emerging countries as Brazil, India, Indonesia, South Africa and Turkey, recently called as the Fragile Five. In this paper, we have four goals. We examine how these three historical shocks mentioned above affect not only the size but also the persistence of the volatilities among 1) exchange rates and 2) ten-year bond rates of the Fragile Five. We also investigate separately the dynamic interactions between 3) exchange rates and 4) ten-year bond rates of the Fragile Five. To that end, we first estimate a multivariate GARCH model (VAR-BEKK model) and derive conditional variances and dynamic (time varying) conditional correlations with covariances. Then, we analyze the effects of these historical shocks on the volatilities of exchange rates and interest rates. We utilize volatility impulse response functions (VIRFs) developed by Hafner and Herwartz (2006) to achieve these objectives. Our results suggest that all three shocks have large and positive impacts on expected conditional variances of the exchange rate and bond rate returns of the Fragile Five. Specifically, Brazil seems to be the most responsive country among the Fragile Five to the shocks under investigation both in exchange rate and bond markets, while India appears to be the least sensitive one. Regarding the dynamic conditional correlations (DCCs) among the exchange rate and ten-year bond markets of the Fragile Five, we find that the DCC series of bond returns exhibit much lower correlations than those associated with exchange rate returns. This result indicates that ten-year bond markets provide a better diversification opportunity than foreign exchange markets in the Fragile Five. However, our results demonstrate that the correlations among the ten-year bond markets exhibit more volatility than the ones among exchange rate markets.

Detecting the Great Short Squeeze on Volkswagen: Regional Price Variation and Limits to Arbitrage

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Abstract

For several crazy hours on 28 October 2008 a short squeeze on Volkswagen stock (VOW.DE) propelled this German car manufacturer to become the world's most valuable company. I study the trading empirically and find measurable signs of anomalous behaviour more than 24 hours before the price peak. The German trading environment provides a window into market health through its array of traditional security exchanges in parallel with a primary electronic trading platform. Under normal trading conditions the law of one price enforces substantially similar prices across all the exchanges. Regional price variation becomes significant when the short squeeze occurs. I find the coefficient of variation between the stock exchanges is a leading indicator of the Volkswagen price spike.

International Stock Market Returns and the Response to Economic Freedom and Corruption Indices

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Abstract

The performance of twenty-nine stock markets is examined over the period December 1995 through October 2014. The markets investigated are a range of developed and emerging markets, ones from countries readily classified as western in focus versus others as non-western or perhaps as eastern. The measures of economic freedom and corruption are based on the Heritage Foundation indices over the twenty years from its inception. The data are used as first differences to capture possible market response to new information. Additional control variables are used for emerging market impacts, western facing and year effects. The release of index data is related to a significant effect on market returns across the sample. This response during the release month is positive meaning there is an associated increase in market returns during the month. Interestingly the response to the change in overall economic index score and the freedom from corruption score appear oppositely signed. The result though is logical given that an improvement in overall score leads to reduce ‘perceived risk’ thus lower market returns and while the improvement of freedom from corruption leads to a higher return impact possibly from the expected better payoff flow to investor as take diminishes. One key conclusion is that (perceived) changes in corruption and economic freedom are associated with market return changes during the month of announcement.

Credit Spread Decomposition: A Regime Shift Approach

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Abstract

Portfolio managers and analysts in fixed income markets face the difficult challenge of correctly decompose credit spreads into changes in its non-observable risk premiums in order to make proper tactical and strategic decisions. As an additional hurdle, the non-linear nature of credit spreads turns this challenge even more complicated, since credit spread variations can respond to fluctuations in fundamentals or market perceptions on these fundamentals. Markov switching (MS) models are the perfect tool to face the task described above, yet they not been used so far in risk premium decomposition exercises. This paper proposes a new framework to decompose credit spreads into risk premiums using a MS model with an application to an investable Emerging Market (EM) Sovereign Fixed Income Index. Results show that credit default risk, gauged by theoretical CDS premiums, is the single most important driver of EM sovereign credit spreads in time. The model also shows that in scenarios of financial stress, market perceptions tend to soften credit risk impact on credit spreads. This might be attributed to less responsiveness in fixed income markets relative to price discovery of risk in CDS markets, as EM sovereign debt is presumably favored by safe-haven demand and "strong-hands" of long-only investors, both possible only in fixed income markets. Finally, the model successfully detects all recent financial stress scenarios even in real-time analysis, a very useful result for market participants to detect regime shifts in EM credit spread behavior.

Financial Crisis and the Supply of Corporate Credit

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Abstract

Analyzing syndicated loan and public debt originations by publicly traded U.S. firms between 2004 and 2011, we document a sharp migration from bank borrowing to either no borrowing or public debt issuance in the crisis years. A significant portion of the migration was driven by overall distress in the banking industry and a subsequent tightening of lending standards. To conserve liquidity, banks that were relatively more distressed curtailed credit further. Matching each firm with its lead bank, we provide direct evidence for the bank lending channel by showing the migration in debt funding outcomes was more prominent for firms that had established relationships with lead banks that became relatively more distressed during the crisis. The ability of many publicly traded firms to promptly disintermediate and issue their own debt provided important financial flexibility. The damage to the broader economy from the bank lending channel was large, nevertheless, potentially accounting for nearly two-thirds of the decline in nonresidential fixed investment and half of the decline in GDP in 2009. Sticky interest rates and a surge in loan commitment drawdowns suggest that bank credit rationing was prevalent during the crisis. Many firms originated public debt at interest rates far higher than syndicated loan rates.

A Note on How to Compute Unlevered Betas for Highly Levered Companies

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Abstract

The expected cost of capital is usually obtained by estimating its individual components, the cost of debt and the cost of equity, and computing a WACC. Unfortunately, in the presence of risky debt, the standard methodology produces a systematic overestimation. This bias is increasing in leverage and volatility of assets. In this paper, we propose a novel methodology to compute the expected return on assets by estimating the unlevered beta from a time series of assets returns constructed on the basis of Merton (1974)'s model.

Investors Vis á Vis New Audit Report – Research in the Republic of Macedonia

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Abstract

IAASB with the proposed amendment of ISA 700, 705 and 706, as well as with the new ISA 701 of June 2014 has made a serious step towards satisfying the investors' requirements for increased communication value and information power of the audit report. The initial initiative for recomposing of the audit report commenced in May 2012 with the document titled Consultation Paper: Enhancing the Value of Auditor Reporting: Exploring Options for Change that is the basis of the investors' expectations for the audit report, especially for the audited public interest entities to see more detailed information related to the professional judgment of the auditor regarding the continuity, risks identification, compliance with the Code of Ethics, disclosure of the engagement's partner name, etc. Inspired by the amendments on the International Standards on Auditing related to the audit report we conducted a research that comprises the bigger investors in the Republic of Macedonia. Purpose of the research is to provide an answer to the question: Does the recomposed audit report contribute to better understanding of the auditor's duties, audit process, audit assurance and other relevant subjects or other additional information are needed to facilitate the decision making process by the users of the audit report? The paper is consisted of four parts. The first part is focused on the investors' perception related to the communication and information power of the audit report. The second part sublimates the researches and publications of the evolutionary development of the audit report. In the third part is given an overview of the methodology of the research for the value and relevance of the information contained in the audit report. Finally, in the fourth part are summarized the results of the conducted research.

Venture Capital: Perspectives On Entrepreneur, Entrepreneurship And Spin-Offs

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Abstract

We analyze the factors that influence an entrepreneur formation and development. Using Entrepreneurial Studies literature we provide a discussion to understand the spin-offs difficulties in Brazil. Our focus is São Paulo State University Innovation Agency (AUIN). Based on AUIN SWOT matrix we explore the entrepreneur and strategies and critical elements to the agency. Our approach is based on comparative studies to be employed for AUIN strategy. We expect to contribute to AUIN strategy for developing entrepreneurs and Spin-offs with a proposal that provides experience on organizations and business. A necessary condition for AUIN, we believe, is to dominate all stages of a business and this is not represented by the two-stage entrepreneur – firm, but a three stage: entrepreneur – knowledge – firm.

The Wealth Effects of Stock Certificate Dematerialization

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Abstract

This research investigates the wealth effect to firms deciding to eliminate paper stock certificates in favor of digital stocks. The move to e-stock certificates is officially called dematerialization. The move to digital stocks has been optional for several years. The transition will be so universal in the United States. This study uses standard event study methodology to test for significant abnormal returns to investors in companies whose Board of Directors voluntarily decide to go digital with their stock certificates. The literature describes the decision for dematerialization as a means of cost savings, as a move to paperless equity issuance. If future costs are lower with no impact on business operations or the financial expenses of the firm, then the move should result in more future cash flow. The decision by management should be a positive net present value decision and thus increase firm value. One argument is that the dematerialization of stock certificates may not be a material action by the firm. Thus, the null hypothesis is no impact no firm value. The alternative hypothesis is that there is a positive impact on firm value.

Financing Sources: Benefits in use of Banking Resources by Investor Clients

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Abstract

This article considers the use of credit lines provided by Caixa Econômica Federal with the maintenance of financial applications as a reserve box or as a guarantee of contracted credit operation. In this way we obtain interest rates reduced and differentiated conditions. The context of this article presents four demonstrations of utilization of credit lines in this situation to proof of their viability. The result obtained found that in some situations there is an advantage in the use of bank loan in favor of a financial investment, it may still be advantageous only for a period in the case of limits and in other situations not be feasible. Therefore, the financial management is essential in the decision to use a bank loan, which option is best and what time.

Acquirer Performance When Founders Remain in the Firm

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Abstract

This paper explores the impact of founders on acquirers' merger performance. The results show that the acquisition of founding firms has a relatively negative impact on acquirers' performance, whereas founders who remain in a firm post-merger have a relatively positive influence. Moreover, I find statistically significant differences between the acquirers of firms where founders remain and the acquirers of firms where founders leave. The acquirers of firms in which founders remain exhibit a higher Tobin's q and greater cumulative abnormal returns. The phenomenon is more prominent when founders remain as daily executives than when founders remain as non-daily directors. Additionally, the length of time that the founders remain with the merged firm affects the findings. Finally, I document a robust positive relationship between the remaining founders and acquirers' value or stock returns, indicating the value of founders to acquirers.

Do Executives Have Free Rider Problem-Evidence from Executive Compensation

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Abstract

Agency problem not only happens between shareholders and managers, but also exists within executives. Compensation is generally rewarded to executives based on firm performance, whereas pay-for-performance principle may cause free rider problem due to the same firm performance to each executive. I investigate free riding problem among seven top executives (CEO, CFO, COO, CMO, CSO, CTO and CHO), and the negative impact on firm value. The results reveal that the second-tier executives (CMO, CSO, CTO and CHO) have more intensive free rider problem than the first-tier executives (CEO, CFO and COO). The paper suggests that executive compensation is better to be rewarded in line with firm value and executive contribution.

What are the Key Determinants of Nonperforming Loans in CESEE?

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Abstract

Credit risk assessment is a crucial part of macroprudential analysis, with the aggregate nonperforming loan (NPL) ratio serving as a proxy for the economy-wide probability of default of the banking sector's overall loan exposure. Therefore, the factors driving the NPL ratio deserve a lot of interest. This study provides a macroeconomic model for nonperforming loans (NPLs) for the Central, Eastern and Southeastern European (CESEE) countries. It is based on panel data for Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Russia, Slovakia and Ukraine. In line with current literature, our empirical analysis confirms that economic growth is the main driver that is negatively correlated with NPL development. This inverse relation is also indicated by the stock index as a leading indicator for economic developments. However, there are also other important determinants that can help explain the change in NPL ratios in the CESEE countries: past credit growth as well as exchange rate changes coupled with the share of foreign currency loans in total loans. This study confirms and quantifies risk of excessive credit growth as well as foreign exchange lending.

The Impact of Corporate Governance on the Financial Performance of Islamic Banks: Some New International Evidence

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Abstract

The aim of the present study was to investigate the impact of corporate governance (CG) on the financial performance of Islamic Banks (measured in terms of ROA & ROE). The corporate governance measures tested were (1) board size; (2) the presence of female board members; (3) the duality of the CEO; (4) the proportion of block holders; (5) the existence of a Shari'ah committee and (6) the size of the Shari'ah committee. The study was based on a sample of 102 Islamic banks from 24 different countries worldwide over the period 2008 - 2012. Statistical methods were used to test the hypotheses, including consideration of partial correlation and use of the t-test. An econometric model was also specified and the regression equations were calculated using Multiple Regression analysis. The findings indicated that some factors had a noticeable impact on financial performance, for example board size and the presence of block holders, while the effect of CEO duality was only partial (on ROE only). Other independent variables had no influence at all. The contribution of this study to the relevant literature may be summarised as follows. First, it is the only study undertaken to date focusing on the effect of CG on the financial performance of Islamic Banks. Second, it examines some specific CG governance variables for the first time, such as the existence and size of a Shari'ah committee. Finally, some recommendations for further research are suggested.

Rethinking Exposure to Emerging Markets: Is it Time to Dive Back

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Abstract

Emerging markets have lately been the subject of many alarming stories filled with warnings of potentially magnified risks and severe liquidity problems for those who remain invested in them. Using a database of 68 emerging-market funds and statistical tools commonly used by the market, this study thoroughly analyzes their performance from various angles. It determines that although investors who had exposure to emerging markets have indeed suffered large losses, the situation doesn’t nearly warrant the current negative hype surrounding them. Not all asset classes were affected to the same extent, and although high risks including liquidity problems still apply when entering these markets, there are also internal sources of growth and very favorable correlations with developed markets. While some keep calling for further pullbacks, this study finds that, on the contrary, the favorable current valuations mean that now is the time to increase exposure to these markets.