OPERATING PERFORMANCE AND SEQUENCE OF CONVERTIBLE BONDS

Onur Arugaslan, Department of Finance and Commercial Law, Western Michigan University, Kalamazoo, MI, U.S.A.
Ajay Samant, College of Business, Illinois State University, Normal, IL, U.S.A.
Devrim Yaman, Haworth College of Business, Western Michigan University, Kalamazoo, MI, U.S.A.

dx.doi.org/10.18374/JIFE-20-1.1

ABSTRACT

This paper studies the relationship between the convertible bond issue sequence and the issuing firms' operating performance. The results show that firms that issue convertible bonds multiple times have higher operating performance compared to firms that issue these bonds once. The operating performance for the first issue of firms that make multiple offerings is also higher than the performance of single issuers. The results also indicate a negative relationship between convertible bond sequence and operating performance.

Keywords: *Operating performance, convertible bonds*

1. INTRODUCTION

Several previous papers have studied the operating performance of convertible bond issuers (See Bae, Jeong, and Tang (2002), McLaughlin et al. (1998a), Hansen and Crutchley (1990), Lewis, Rogalski and Seward (2001), and Lee and Loughran (1998).). These studies illustrate that overall convertible bond issuers' operating performance are positive prior to the bond issue.

A shortcoming of these papers is that they usually average the operating performance of all bond issues in their sample. Iqbal (2008) and D'Mello et al. (2003), however, show that for rights and equity issues the stock performance varies with each issuance in an issue sequence. Our study evaluates whether the sequence effect occurs for the operating performance of convertible debt issues.

We focus on a sample of 814 convertible bond issues and our sample period is 1985 to 2011. 592 firms had only one offering in this sample period and firms that made multiple offerings made 222 of these issues. We observe that firms that offer convertible bonds more than once during our sample period have better operating performance compared to firms that offer these bonds only once. This result persists even after we control for other factors that affect the operating performance of the issuers of convertible bonds.

Our result is consistent with the argument that high-performing firms issue convertible bonds frequently to raise funds for future growth. Our results also show a better operating performance for multiple issuers than single issuers even before the first issue. We also find some evidence that for multiple issuers the operating performance is better for the former issues compared to latter issues.

This finding supports the argument that companies take on more profitable projects early on in the sample period and the incremental returns from each consecutive project may be declining, resulting in lower operating performance in each consecutive convertible bond issue.

The rest of the paper is organized as follows: In the next section, we summarize prior research on the operating performance of companies that issue convertible bonds and the impact of sequence on security issuance. In section 3, we develop the hypotheses we test and in section 4 we present our results. In section 5, we conclude our paper.