



**The Impact of Bond Ratings
On Market Efficiency and Stock Returns**

Ambalagam Marappan

Master in Business Administration

**Submitted to the Faculty of Business and Accountancy,
University of Malaya, in partial fulfillment of the
requirements for the Degree of
Master in Business Administration**

September 2002



Acknowledgements

I wish to take this opportunity to thank Ms Izlin Ismail for her sincere efforts in guiding me to complete this paper

Table of Contents

TABLE OF CONTENTS	1
CHAPTER ONE INTRODUCTION	2
1.1 PURPOSE AND SIGNIFICANCE OF STUDY	2
1.2 RESEARCH QUESTIONS	4
1.2 SCOPE OF STUDY	4
1.4 LIMITATIONS OF THE STUDY	6
1.5 ORGANISATION OF THE STUDY	8
CHAPTER TWO THEORY DEFINITION	10
2.1 CREDIT RATINGS	10
CHAPTER THREE LITERATURE REVIEW	17
3.1 MARKET EFFICIENCY	17
3.2 BOND RATINGS	21
3.3 EVENT STUDY	24
CHAPTER FOUR METHODOLOGY	26
4.1 RESEARCH HYPOTHESES	26
4.2 SELECTION OF MEASURES	26
4.3 SAMPLING DESIGN	40
4.4 DATA COLLECTION PROCEDURES	43
4.5 DATA ANALYSIS TECHNIQUES	45
CHAPTER FIVE DATA ANALYSIS	50
5.1 SUMMARY STATISTICS OF RESPONDENTS	50
5.2 ANALYSIS OF MEASURES/TESTING OF HYPOTHESES.....	50
5.2 SUMMARY OF RESEARCH RESULTS	58
5.2.1 <i>Market Efficiency</i>	58
5.2.2 <i>Impact on stock returns</i>	59
CHAPTER SIX CONCLUSION AND RECOMMENDATIONS	61
6.1 SUMMARY AND CONCLUSION.....	61
6.2 SUGGESTIONS FOR ADDITIONAL RESEARCH	61
6.3 IMPLICATIONS.....	62

Bibliography

APPENDICES

Appendix 1.0

- 1.1 Initial Assignment (year of rating announcement)
- 1.2 Initial Assignment (rating grade)
- 1.3 Reaffirmed (year of rating announcement)
- 1.4 Reaffirmed (rating grade)
- 1.5 Rating Upgrade (year of rating announcement)
- 1.6 Rating Upgrade (rating change)
- 1.7 Rating Upgrade (rating grade)
- 1.8 Rating Downgrade (year of rating announcement)
- 1.9 Rating Downgrade (rating change)
- 1.10 Rating Downgrade (rating change)

Appendix 2.0

- 2.1 Computation of Abnormal Returns - Initial Assignment
- 2.2 Computation of CAR and t-Values - Initial Assignment
- 2.3 Computation of Abnormal Returns - Reaffirmation
- 2.4 Computation of CAR and t-Values - Reaffirmation
- 2.5 Computation of Abnormal Returns - Upgrades
- 2.6 Computation of CAR and t-Values - Upgrades
- 2.7 Computation of Abnormal Returns - Downgrades
- 2.8 Computation of CAR and t-Values - Downgrades

Appendix 3.0

- 3.1 Chart- Initial Assignments
- 3.2 Chart- Reaffirmation
- 3.3 Chart- Upgrades
- 3.4 Chart- Downgrades

The Impact of Bond Rating Announcements on Market Efficiency and Stock Returns

Abstract

This paper examines the impact of bond rating announcements by Rating Agency of Malaysia (RAM) on market efficiency and stock returns in Malaysia. Four types of announcements were selected for the study viz. initial assignments, reaffirmations, upgrades and downgrades for the period ranging from 1996 through 2001. Each of the rating categories is sampled according to investment, speculative and summary levels. The market model was used in determining abnormal returns for the study.

A statistically insignificant reaction was found for all the four categories of rating announcements in all the sub-samples in terms of abnormal returns and stock returns for the event window period. The results suggest that the evidence supports market efficiency in the semi-strong form in the Malaysian market. However, evidence also suggests that one would not profit by taking positions based on rating announcements by RAM as it does not appear to provide new information to the market but merely providing information already available in the market place.