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## Convertible bond announcement effects: Why is Japan different?

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### Abstract

U.S. and Japanese firms dominate global convertible bond issuance. Previous research documents more favorable convertible bond announcement effects in Japan than in the U.S. and other developed countries. Using a global sample of convertible bonds issued from 1982 to 2012, we find that the more favorable announcement effects of Japanese convertibles are driven by their stated uses of proceeds. Japanese convertibles more often include capital expenditure as an intended use, while U.S. firms tend to mention general purposes to motivate their offering. Our findings illustrate the value to firms of being more explicit when disclosing the intended use of proceeds of security offerings.

Keywords: Convertible bonds; capital expenditure; disclosure standards; Japan; stated use of proceeds

JEL codes: G15, G32

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## 1. Introduction

Convertible bonds are hybrid securities with features of both debt and equity. They are an important source of financing throughout the world. From 1982 to 2012, convertible bond issuance volume amounted to \$286.93 billion in the U.S. and \$287.15 billion in Japan, the two countries that dominate global convertible bond issuance.<sup>1</sup>

Consistent with the signalling model of Myers and Majluf (1984), event studies on stock price reactions to convertible bond announcements by U.S. firms document negative stock price effects (Dann and Mikkelson, 1984; Eckbo, 1986; Mikkelson and Partch, 1986). Outside the U.S., Magennis et al. (1998) and Abhyankar and Dunning (1999) find negative announcement effects for the Australian and the U.K. markets, respectively, and Burlacu (2000), Ammann et al. (2006), and Dutordoir and Van de Gucht (2007) find negative effects for convertibles issued in Continental Europe.

In contrast with results for the rest of the world, event studies for the Japanese market tend to find a positive or neutral convertible bond announcement effect (Kang et al., 1995; Christensen et al., 1996; Kang and Stulz, 1996). Researchers have attempted to explain why the announcement effect of convertible bonds in Japan is different, but no consensus has been reached. Some studies argue that this difference could be driven by the existence of keiretsu corporate groupings in Japan (Kato and Schallheim, 1993; Kang et al., 1995; Christensen et al., 1996; Kang and Stulz, 1996).<sup>2</sup> Kang et al. (1995) and Kang and Stulz (1996) argue that differences between the goals of Japanese and U.S. managers may also lead to different security offering announcement returns. Japanese managers tend to be focused on market share rather than shareholder value. On the one hand, this may result in weaker incentives for Japanese managers to time equity-linked offerings to exploit equity overvaluation, resulting in less negative stock price reactions to Japanese security offerings. On the other hand, the

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<sup>1</sup> Source: own calculations, based on data from the Securities Data Company's Global New Issues database.

<sup>2</sup> A keiretsu corporate group is a set of companies with interlocking business relationships and shareholdings (Christensen et al., 1996).

market may be concerned that Japanese managers search financing to undertake market share-increasing negative-NPV projects, leading to more negative stock price reactions. Finally, Christensen et al. (1996) focus on institutional differences between convertible bond announcement procedures in the U.S. and Japan. Unlike U.S. convertible announcement and issuance, which often happens overnight (De Jong et al., 2011), the announcement process in Japan is much lengthier, and therefore more prone to information leakage prior to the official announcement date. This might weaken the negative information content of Japanese convertible bond announcements.

A common feature of the above studies is that they focus on a sample of Japanese convertibles.<sup>3</sup> Our paper intends to shed more light on the reasons for the more favorable stock price reactions to Japanese convertibles by analyzing stock price reactions for a global sample of convertibles, including offerings from Japan, the U.S., and other developed countries. The cross-country nature of our study allows us to formally examine potential factors causing the differences in stock price reactions across countries.

Next to firm-, security-, and market-specific factors suggested by previous studies, we also analyze a thus far unexplored potential explanation, i.e. we focus on differences in the stated uses of proceeds of Japanese convertibles and convertibles issued in other countries. When announcing a security offering, firms commonly mention how they intend to use the proceeds of the offering. The prospectus of the offering also includes these stated uses. Several studies find that equity(-linked) offerings with capital expenditure as a stated use of proceeds result in less negative stock price reactions, compared with offerings with other stated uses such as debt refinancing or general purposes (Abhyankar and Dunning, 1999; Walker and Yost, 2008). The market appears to consider a stated intention of using offering proceeds for capital expenditure as a credible signal that the offering is motivated by the

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<sup>3</sup> Kang et al. (1995) consider offshore U.S. convertibles issued in the Japanese market, but these represent only a small subset of U.S. convertibles.

presence of profitable investment opportunities, rather than by market timing motives (Autore et al., 2009). McConnell and Muscarella (1985) find a positive stock price effect for corporate announcements to increase capital expenditure, which further corroborates that the market interprets stated intentions to engage in capital expenditure as good news. We therefore examine whether the reason for the less negative announcement effect of Japanese convertible bonds lies in the fact that these issues more often state capital expenditure as an intended use of the offering, compared with convertibles issued in the rest of the developed world.

To examine this question, we use a sample of convertible bonds issued between January 1982 and April 2012. Our event study results confirm that the cumulative abnormal return (CAR) for convertible bonds issued by Japanese firms is significantly less negative than for convertibles issued in other developed countries. The average announcement-period CAR for Japanese convertibles ( $-0.80\%$ ) is  $2.38\%$  higher than the average CAR for U.S. convertibles ( $-3.18\%$ ) and  $0.63\%$  higher than the average CAR for convertibles issued in other developed countries ( $-1.43\%$ ).

When exploring the reasons for these differences, we find that, unlike for convertibles issued in other developed countries, stated purposes for the majority of Japanese convertible bonds include ‘capital expenditure’ as an intended use. Our cross-sectional regression analysis reveals that differences in stock price reactions between Japanese and other convertibles are no longer significant when controlling for differences in the stated uses of proceeds. Our regressions control for a wide range of firm-, security-, and market-specific variables, as well as for the endogeneity of stated uses of proceeds.

In a next step, we examine the correspondence between stated and actual uses of proceeds of convertible bond issues using the approach of Walker and Yost (2008). Unlike their Japanese counterparts, U.S. convertible bond issuers realize strongly significant

increases in capital expenditure post-offering regardless of the stated uses of their offerings. Surprisingly, increases in median capital expenditure to total assets ratios are actually significantly larger for U.S. convertible bond issuers than for Japanese issuers. U.S. issuers thus seem to under-state the importance of capital expenditure as an intended use of convertible bond offering proceeds, and instead resort to the catchall phrase ‘general purposes’ to motivate their offering. We document that differences in disclosure standards between the U.S. and Japan, albeit subtle, may provide an explanation for this finding. More particularly, our analysis suggests that U.S. standards for disclosure of stated uses of proceeds require less detail than Japanese standards. Our evidence also suggests that U.S. convertible bond issuers may have weaker incentives to provide specific information on intended uses of proceeds due to a higher ex ante uncertainty, in line with the rationale of Dye (1985). We do not find strong evidence that cross-country differences in stated uses of proceeds are related to differences in proprietary costs of disclosure (Verrecchia, 1983) or agency costs (Mahoney, 1995) between Japanese and other firms.

Our study provides three main contributions to the literature. First, our work addresses the long-standing puzzle why Japanese convertibles generate less negative stock price reactions than convertibles issued in other countries. Second, we update existing event study results on stock price reactions to Japanese convertibles, which tend to be at least a decade old. Whilst several previous studies find positive stock price reactions, our findings indicate that Japanese convertibles result in negative reactions, albeit significantly smaller in size than in the U.S. and other developed countries.<sup>4</sup> Third, we add to a small stream of studies on the impact of stated uses of proceeds on short- and long-term stock price behavior following security offering announcements (Abhyankar and Dunning, 1999; Walker and Yost, 2008; Autore et al., 2009; Silva and Bilinski, 2015; Walker et al., 2015). The key implication of our

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<sup>4</sup> Cheng et al. (2005) also find a significant negative stock price reaction for a sample of Japanese convertibles issued between 1996 and 2002.

study is that firms should consider being more explicit in their stated uses of proceeds, as investors seem to use these stated uses as a signal about the extent to which the offering may increase future cash flows.

The remainder of this paper is organized as follows. Section 2 describes the data set. Section 3 presents the methodology and descriptive statistics. Section 4 provides our main results on stock price reactions to convertible bond announcements. Section 5 discusses a number of potential explanations for our findings. Section 6 concludes.

## **2. Data**

We obtain a sample of convertible bond offerings made between January 1982 and April 2012 from SDC Platinum's Global New Issues database (henceforth SDC). Stock price, balance sheet, and income statement data are from Datastream. We apply the following criteria to select offerings for inclusion in our final sample:

- The convertible must be issued by a company domiciled in a developed country with more than 15 convertible bond issues in total from 1982 to April 2012. This means that our sample includes offerings from Australia, Canada, France, Germany, Japan, the Netherlands, Switzerland, the U.K., and the U.S.;
- The convertible must be issued by an industrial company. We exclude issues from firms which may face regulation restrictions, i.e., utilities (SIC codes 4900 to 4999), banks (SIC codes 6000 to 6199), and non-bank financial firms (SIC codes 6200-6299, 6300-6499, and 6500-6999);
- The offering must be convertible into the issuing firm's stock. We exclude exchangeable bonds;
- The convertible must either be a public offering, or an offering made under Rule 144a;

- The offering's issue date must be available on SDC;
- The offering's stated use of proceeds must be available on SDC;
- The issuing firm's daily stock price data for the full calendar year preceding the announcement date must be available on Datastream;
- The issuing firm's balance sheet and income statement data for the fiscal year-end immediately prior to the announcement date must be available on Datastream.

We consolidate multiple issues of convertible bonds made by the same firm on the same day into one offering.<sup>5</sup> Table 1 shows annual convertible bond issuance numbers and U.S. dollar proceeds for Japan, the U.S., and other developed countries over the sample period. The dataset consists of 3,378 convertible issues. More than half of the convertible bonds (1,806 issues, or 53.46%) are issued by Japanese companies. The U.S. account for 1,119 issues or 33.13%, and a further 453 issues (13.41%) are made by firms in other developed countries. Prior to 2000, the number of Japanese convertibles is consistently higher than the number of U.S. convertibles. After 2000, this pattern reverses, possibly due to the large increase in the importance of convertible arbitrage hedge funds in the U.S. around the turn of the century (Duca et al., 2012). Total proceeds of Japanese convertibles (\$287.15 billion) are slightly higher than total proceeds of U.S. convertibles (\$286.93 billion), and substantially higher than total issuance proceeds for other developed countries (\$73.40 billion).

[Please insert Table 1 here]

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<sup>5</sup> As a result, the number of observations for Switzerland and the U.K. drops below 15, but we keep these countries in our sample.



### 3. Methodology

This section describes the methodology used for analyzing stock price reactions around convertible bond announcements and provides descriptive statistics. To estimate abnormal stock returns, we follow conventional event study methodology as in Brown and Warner (1985). For convertible bond issues that have a filing date in SDC, we take the filing date as the announcement date. For issues that do not have a filing date in SDC, we instead take the issue date provided by SDC as the announcement date. We use market model regressions estimated over days  $-250$  to  $-10$  before the announcement date (day 0) to calculate normal stock returns, and then subtract these returns from actual stock returns to obtain abnormal stock returns. We sum abnormal stock returns over trading days  $-1$  to  $1$  surrounding convertible bond offering announcement dates, thus obtaining cumulative abnormal stock returns (CARs).

A next step in our research design involves developing dummy variables capturing the different stated uses of proceeds. Each dummy variable equals one if one particular purpose is mentioned in the stated use of proceeds obtained from SDC, and zero otherwise. The stated uses of proceeds obtained from SDC fall into the following five main categories: Capital expenditure, debt refinancing, acquisition, working capital, and general purposes. We code the capital expenditure dummy variable as one if the stated use of proceeds reported in SDC includes 'Capital expenditure', 'Buildings', 'Construction', and/or 'Land infrastructure'; the debt refinancing dummy variable as one if the stated use of proceeds includes 'Refinancing', 'Indebtedness', 'Borrowings', 'Repurchase', 'Mortgage', 'Recapitalization', 'Redeem' and/or 'Restructuring'; the acquisition dummy variable as one if the stated use of proceeds includes 'Acquisition', the working capital dummy variable as one if the stated use of proceeds includes 'Working capital'; and the general purposes dummy variable as one if the stated use

of proceeds includes ‘General’. We omit 108 offerings for which we cannot classify the stated uses of proceeds within any of these five categories.

Table 2 reports the percentage and numbers of stated uses falling into each of the five categories for Japan, U.S., and the other developed countries represented in the sample. Percentages are obtained by dividing the number of occurrences of each stated use by the total number of convertibles for each subsample (i.e. 1,806 for Japan, 1,109 for the U.S., and 453 for other developed countries). The sum of the percentages of stated uses for each of the three subsamples (obtained by summing percentages across each row) is larger than 100%, because several offerings include more than one stated use of proceeds.<sup>6</sup> Remarkably, among Japanese convertible bonds, 74.6% of the issues mention capital expenditure as an intended use, whereas the corresponding percentages for U.S and other developed countries are much lower (4.6% and 14.1%, respectively).

[Please insert Table 2 here]

Next to stated uses of proceeds, our analysis controls for a range of firm-, issue-, and market-specific characteristics. Appendix I provides a definition and source of the explanatory variables used in the regression analysis. All firm- and market-specific characteristics are measured at the fiscal year-end preceding the convertible bond issue date. We now motivate these characteristics and outline their predicted impact on stock price reactions.

Several rationales argue that convertibles are able to mitigate debt- or equity-related financing costs (Green, 1984; Brennan and Schwartz, 1988; Stein, 1992; Mayers, 1998; Brown et al., 2012). However, within a sample of convertible bond issues, we expect

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<sup>6</sup> In a robustness test discussed further in the paper, we only include offerings with a single stated use of proceeds, with similar results.

announcement effects to be negatively affected by proxies for debt- and equity-related financing costs, due to the hybrid debt-equity nature of convertibles (Dutordoir and Van de Gucht, 2007). We include firm size, measured as the logarithm of the book value of total assets (LnTA), as an inverse proxy for the magnitude of firms' debt- and equity-related financing costs. Larger firms tend to have lower costs of financial distress, as well as lower levels of information asymmetry about their firm value and risk, for example because they are followed by a larger number of analysts (e.g., Elliot et al., 1984; Chae, 2005). We therefore expect a positive impact of LnTA on stock price reactions.

Firms with a higher debt ratio may have higher costs of attracting new debt financing because they have more potential for asset substitution (Green, 1984) and higher risk-related adverse selection costs (Brennan and Kraus, 1987; Brennan and Schwartz, 1988). Thus, we predict stockholder reactions to convertible bond announcements to be negatively influenced by the ratio of total debt to total assets (debt/TA).

Stock run-up is measured as the continuously-compounded non-market-adjusted daily stock return over trading days  $-60$  to  $-2$  prior to the convertible bond issue date. A firm with higher stock run-up is more likely to be perceived as overvalued by stockholders (Lucas and McDonald, 1990). On the other hand, a larger pre-issue stock runup may signal more profitable growth opportunities, thereby lowering equity-related financing costs (Viswanath, 1993). We therefore have no clear expectations on the impact of the stock run-up.

We also control for the overall equity market run-up, measured as the continuously-compounded non-market-adjusted daily market index (S&P 500) return over trading days  $-60$  to  $-2$  prior to the issue date. Market expansions tend to be associated with more profitable growth opportunities, and therefore lower economy-wide adverse selection costs (Choe et al., 1993). Therefore, we expect the market run-up to have a positive impact on stock price reactions to convertible bond announcements.

Stock return volatility is the annualized volatility of daily stock returns over trading days  $-250$  to  $-10$  relative to the convertible bond issue date. Firms with higher ex ante volatility in their stock returns are expected to face higher uncertainty regarding their cash flows, and therefore larger costs of financial distress (Chang et al., 2004). We thus expect that stock return volatility is negatively related to the abnormal return associated with convertible bond offerings. Stock return volatility might also proxy for the equity-likeness of the convertible, as a convertible is more equity-like (i.e. the exchange option is more likely to get in-the-money) when returns are more volatile (Burlacu, 2000). Following Myers and Majluf's (1984) rationale that more equity-like offerings provide a stronger signal of firm overvaluation, this also yields the prediction of a negative impact of stock return volatility on stock price reactions.

Market return volatility is the annualized market return volatility, calculated from daily returns on the S&P 500 index over trading days  $-250$  to  $-10$  relative to the issue date. Choe et al. (1993) suggest that there is a strong positive relation between market return volatility and information asymmetry. Given that higher information asymmetry tends to strengthen the adverse selection problem documented by Myers and Majluf (1984), we expect a negative impact of market return volatility on stock price reactions to convertible debt announcements.

Slack/TA is cash and short-term investments divided by total assets. De Jong and Veld (2001) argue that firms with higher financial slack are more likely to spend the offering proceeds on negative NPV-projects, given that slack capital should result in a lower genuine need to tap external financing. In other words, higher slack worsens agency problems between managers and external capital providers, and should be associated with more negative stock price reactions to convertible bond announcements.

In addition to these issuer characteristics, we also control for two issue-specific variables, i.e. maturity and relative offering proceeds. Maturity captures the time between the

issue date and the final maturity date of the convertible bond offering. Several studies (e.g., Easterbrook, 1984; Datta et al., 2000) suggest that firms with better expected stock price performance have incentives to issue convertible bonds with longer maturity to postpone the conversion. We therefore expect a positive relationship between maturity and stock price reactions to convertible bond announcements.

Krasker (1986) argues that equity(-linked) offerings with larger offering proceeds send a stronger signal of firm overvaluation, and may therefore lead to more negative stock price reactions. Larger issue sizes might also be associated with more intense short selling activity from convertible bond arbitrageurs (De Jong et al., 2011).<sup>7</sup> We therefore expect a negative relationship between issue proceeds relative to total assets (proceeds/TA) and stock price reactions to convertible bond announcements.

De Jong et al. (2012) find that convertibles issued by firms listed in countries in which short selling is legally restricted are associated with less negative stock price reactions, compared to convertibles issued in countries in which short selling is legally allowed and effectively practiced. We therefore include a short selling dummy equal to one for the sample countries allowing short selling, and equal to zero for the sample countries having a short selling ban in place on the date of the convertible debt issuance. As noted in Appendix I, we obtain data about short selling bans from De Jong et al. (2012). We assume there are no short sale bans in place prior to the start of their sample period in 1990 and after the end of their sample period in 2009, except for France and Germany which still had short selling bans in place. We predict a negative relation between the short selling dummy and stock price reactions to convertible bond announcements.

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<sup>7</sup> Convertibles are often bought as part of an arbitrage strategy, which involves short selling the underlying stock (Choi et al., 2009; De Jong et al., 2011; Brown et al., 2012). This short selling activity results in a temporary stock price drop around the convertible bond issue date, which often coincides with the announcement date (Duca et al., 2012).

Finally, in line with Kang et al. (1995) and Christensen et al. (1996), we control for keiretsu membership of Japanese firms. We obtain data on vertically integrated keiretsu membership from the 2001 Edition of Industrial Groupings in Japan.<sup>8</sup> Our assumption is that keiretsu affiliation remains relatively stable over the sample period, which is confirmed by findings of De Jong et al. (2006). When a keiretsu member issues a security, the reputation of the entire group of companies could be affected, which makes it less likely that overvaluation is the reason for the issue. Therefore, we expect that the keiretsu dummy has a positive impact on the announcement effect of convertible bonds.

Table 3 compares summary statistics of the key issuer-, issue-, and market-specific variables used in this study for Japan, the U.S., and other countries. We find that the median Japanese convertible issuer is significantly larger than median issuers in the other developed countries. Median total assets for Japan, the U.S., and the other developed countries are \$834.21 million, \$625.06 million, and \$85.84 million, respectively. However, the mean of total assets displays a reverse ranking, indicating the presence of extremely large issuers in the U.S. and the other developed countries. The average proceeds/TA ratio of Japanese firms is the lowest among the sample countries, i.e. 13% compared to 31% and 26% for the U.S. and the other countries, respectively. This also explains why, in volume terms, the U.S. is the most important convertible bond issuing country over our sample period, whereas in terms of number of issues, Japan is the most important issuer.

In terms of other firm- and issue-specific control variables, we observe that average debt/TA ratios of Japanese and U.S. issuers are similar, and both significantly higher than in other developed countries. The average stock run-up of Japanese issuers is only 4.27%, which is significantly lower than that of the U.S. and other countries (15.03% and 11.40% respectively). This pattern is consistent with the notion that, due to differences in managerial

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<sup>8</sup> We would like to thank Willem Schramade for kindly sharing his keiretsu data with us.

goals, Japanese issuers might be less inclined to time the offering to exploit stock overvaluation (Kang and Stulz, 1996). We also find that Japanese issuers' average stock return volatility is significantly lower than that of issuers in the U.S. and other countries. The average market return volatility for issues in Japan and the U.S. is lower than for the other countries. Further, we observe that Japanese and U.S. issuers have similar average slack ratios, both in the area of 20%, while average slack ratios for issuers in other developed countries are significantly smaller. Finally, the average maturity of the U.S. convertible bonds is more than twice as high that of bonds issued in Japan and other countries.

[Please insert Table 3 here]

#### **4. Stock price reactions to convertible bond announcements**

##### *4.1 Event study results*

Panel A of Table 4 reports descriptive statistics for cumulated abnormal returns (CAR) associated with convertible bond announcements for each of the three subsamples (Japan, the U.S., and other developed countries). We also report *t*-test (Wilcoxon test) statistics indicating whether the mean (median) CAR for each subsample is significantly different from zero. We find that the mean (median) CAR of Japanese convertibles is  $-0.80\%$  ( $-0.79\%$ ). The U.S. has the most negative average CAR among the sample countries ( $-3.18\%$ ).

Panel B of Table 4 presents statistics for differences in CAR between the three subsamples. The mean CAR of Japanese convertible bonds is  $2.38\%$  higher than for U.S. convertibles. The difference in means between both subsamples is statistically significant at the 1% level. The mean difference in CAR between Japan and other countries is  $0.63\%$ , which is also statistically significant at the 1% level.

[Please insert Table 4 here]

#### *4.2 Regression results*

In the next step of the empirical analysis, we examine potential explanations for the less negative announcement returns for Japanese convertibles documented in the previous subsection. Table 5 reports the results of regression analyses with the CAR over the window  $(-1, 1)$  relative to the convertible bond announcement date as the dependent variable.

Column (1) only includes a dummy variable equal to one for convertibles issued by Japanese companies. In line with earlier univariate findings, the dummy variable has a significantly positive impact. In Column (2), we control for the firm-, issue- and market-specific characteristics specified earlier. We find that the CAR is positively influenced by stock run-up and negatively influenced by stock return volatility, which is in line with our predictions. We do not find a significant impact for the short selling and keiretsu control variables. LnTA has a significantly negative coefficient and market return volatility has a positive coefficient, which is not consistent with our expectations. The most important takeaway from the analysis is that the Japan dummy continues to hold its significantly positive coefficient in Column (2). This suggests that the less negative announcement effects of Japanese convertibles cannot be fully attributed to the firm-, and issue-, and market-specific characteristics included in our regression.

[Please insert Table 5 here]

We next focus on differences in stated uses of proceeds as a potential explanation for the less negative stock price reactions to Japanese convertibles. Figure 1 provides a histogram showing average convertible bond announcement effects (CAR) by stated purpose of issue.



The figure shows that convertible bonds with acquisitions and general purposes as stated uses have the most negative CAR ( $-2.85\%$  and  $-2.76\%$  on average, respectively). Convertibles with debt refinancing and working capital as intended purposes also have negative average announcement effects in the order of  $-2\%$ . Convertibles with capital expenditure as a stated use have the least negative CAR ( $-0.60\%$  on average).

[Please insert Figure 1 here]

To summarize, we find that Japanese convertibles have a higher likelihood of stating capital expenditures as their purpose (Table 2), and that capital expenditure as a stated use of proceeds tends to generate less negative convertible bond announcement returns (Figure 1). This suggests that the less negative announcement returns of Japanese convertibles could be driven by their stated uses of proceeds. We formally examine the validity of this conjecture by estimating a two-step treatment effects model following the methodology outlined in Li and Prabhala (2007). This approach controls for the possibility of omitted variables affecting both the decision to include capital expenditure as a stated use of proceeds for a convertible offering, and the stock price reaction to the announcement of the offering.

[Please insert Table 6 here]

Column (1) of Table 6 reports the results of the model. The first step selection equation consists of a probit model with the capital expenditure dummy as the dependent variable. As noted earlier, this dummy variable is equal to one for offerings mentioning capital expenditure or related terms as a stated use, and equal to zero otherwise. We use the ratio of capital expenditure to total assets as of the fiscal year end prior to the convertible bond issue

date as the instrument (exclusion variable) of the first stage probit. Firms with a higher value for this ratio may require larger investments in their fixed assets, and are thus more likely to mention capital expenditure as the stated use of proceeds of their current offering. By contrast, there is no reason to hypothesize a direct impact of this ratio on the CAR (second stage regression), making it a suitable instrument for our model. This instrument is available for 2,695 of our sample observations.<sup>9</sup>

In line with our prediction, the first step regression results show that firms with a higher capital expenditure/TA ratio prior to the offering are more likely to include capital expenditure as a stated purpose for their convertible bond issue. We also find a positive impact of market return volatility, proceeds/TA, and keiretsu membership, and a negative impact of debt/TA and stock return volatility.

Our main focus is on the second step regression results explaining the CAR. Most importantly, we find that the coefficient on the capital expenditure dummy is significant and positive, while the Japan dummy becomes insignificant. These results suggest that the difference between the announcement effects of Japanese and other convertibles is caused by the fact that Japanese firms are more likely to state that they are going to use the offering proceeds for capital expenditure purposes, compared with other countries.

The correlation coefficient between the error terms of the first and second stage regressions,  $\rho$ , is significant and negative, illustrating the necessity of using the treatment effects model to control for endogeneity.<sup>10</sup> The other findings are largely in line with those in Table 5.

Our stated uses of proceeds dummy variables are coded as one as soon as a particular stated use of proceeds is mentioned by SDC. However, as noted earlier, many offerings

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<sup>9</sup> We obtain similar results for the regression in Table 5 when we restrict that regression to these 2,695 observations.

<sup>10</sup>  $\rho$ 's negative sign indicates that unobservable characteristics increasing firms' likelihood of stating capital expenditure as a stated use have a negative impact on stock price reactions to convertible bond announcements.

include more than one intended use of proceeds. Column (2) of Table 6 therefore repeats the treatment effects analysis with the capital expenditure dummy defined as one if capital expenditure is the only stated use of the offering. The main results still hold under this more stringent definition.

[Please insert Table 7 here]

Table 7 reports a number of further tests of the robustness of the results in Column (1) of Table 6. In Table 7, Column (1), we use net assets growth, defined as the growth rate in the book value of equity over the pre-issuance year, as an alternative instrument in our treatment effects model. Firms experiencing a higher growth rate in their net assets base might be more likely to need further capital expenditure to support ongoing growth. Accordingly, we expect these firms to have a higher likelihood of mentioning capital expenditure as an intended use of proceeds for their convertible bond issue. In line with this prediction, we find a significant positive impact of net assets growth in the first stage probit regression. In the second stage, the Japan dummy again no longer has a significant positive impact on the CAR after including the capital expenditure dummy variable and the selectivity control  $\rho$ . In fact, the Japan dummy's coefficient is now negative, with a  $t$ -test statistic of 1.61, i.e. close to the 10% significance level. Thus, we again find strong evidence that the more favorable announcement effects for Japanese convertibles completely disappear when controlling for the capital expenditure dummy in a treatment effects model.

In Column (2), we consider the potential influence of information leakage on Japanese firms' convertible bond announcement effects. Christensen et al. (1996) find evidence of significant abnormal returns in the trading days prior to official Japanese convertible bond announcement days, and suggest that this could be driven by information leakage before

these announcement dates. A potential explanation for this observation is that Japanese managers tend to face fewer restrictions than U.S. managers regarding informal disclosures of upcoming offers to selected analysts and other interested parties. We use  $(-8, 1)$  as the event window to capture the information leakage, if any, preceding Japanese convertible bond announcements (Christensen et al., 1996, also consider stock price reactions as of day  $-8$ ). The main result that differences in announcement effects of Japanese and other convertibles disappear after controlling for capital expenditure as a stated purpose of proceeds remains robust to the use of this alternative window. The robustness test included in Column (3) will be discussed in the next section of the paper.

## **5. Potential explanations for cross-country differences in stated uses of proceeds**

In this section, we examine potential causes of the strong differences in stated uses of proceeds between Japanese and other convertibles. We believe that this question is relevant in order to better understand the drivers of our results on stock price reactions reported in the previous section. Therefore, this section explores four non-mutually exclusive explanations for the differences in stated uses of proceeds for Japanese and other convertibles.

### *5.1 Stated versus actual uses of proceeds*

The most straightforward explanation is that the differences in stated uses reported in Table 2 reflect differences in actual uses of convertible bond offering proceeds. In other words, Japanese firms may be more likely to use their offerings for capital expenditure purposes, compared with convertible bond issuers in other developed countries. This could in turn be driven by differences in managerial objectives between Japanese and other firms discussed earlier. In a first step, we therefore analyze post-offering firm characteristics for each of the three geographic subsamples (Japan, the U.S., and other developed countries),

following the approach of Walker and Yost (2008). The key question that we want to address through this test is whether Japanese firms effectively realize higher actual increases in capital expenditure following convertible bond offerings, compared with issuers in the U.S. and the rest of the developed world. Next to capital expenditure, we also consider total assets, research and development expenditures, cash, long-term borrowing, and working capital as relevant post-offering firm characteristics. We scale each firm characteristic by total assets measured as of the fiscal year end prior to the offering (year  $-1$ ), allowing us to focus on uses of funds relative to the firm's size prior to the offering. Table 8, Panel A reports medians in the resulting scaled firm characteristics, for the year prior to issuance, the year of issuance (year 0), and the two following years (year 1 and 2), for each of the five categories of stated uses, per geographic subsample. Results are similar when we use average ratios (not reported for parsimony). Significance levels are for Wilcoxon tests assessing the change in the median ratios over year 0, 1, and 2, relative to the value of the median ratio in year  $-1$  (actual values of the test statistics are not reported).

[Please insert Table 8 here]

Panel A allows us to examine correspondence between stated and actual uses of proceeds within Japan, the U.S., and the other developed countries. In the year of issuance (year 0), Japanese issuers increase capital expenditure most strongly when their stated use of proceeds includes capital expenditure ( $p$ -value of increase  $< 0.01$ ). By contrast, their realized increases in capital expenditure are not significant when their stated uses of proceeds include acquisitions or working capital, and are only significant at the 5% (10%) level when they state that they intend to use the offering for general purposes (debt refinancing). U.S. convertible bond issuers, in turn, register strongly significant increases in capital expenditure

regardless of their stated uses. More particularly, results for U.S. issuers indicate that increases in capital expenditure to total assets are always significant at less than 1% in the issuance year as well as in the two years after issuance, except for one case where it is significant at 5%. Convertible bond issuers in other developed countries also register significant increases in capital expenditure regardless of their stated uses during the issuance year, although the statistical significance of the increases in capital expenditures is sometimes weaker than for the U.S. Thus, the key finding emerging from this analysis is that Japanese convertible bond issuers seem to have a stronger correspondence between capital expenditure as a stated use and actual capital expenditure increases, compared with U.S. and other issuers.

As noted earlier, our main focus is on actual capital expenditure following convertible bond issues. Table 8, Panel B allows us to make a comparison of increases in actual capital expenditure across the three geographic subsamples. It gives Wilcoxon test statistics for cross-country differences in increases in median capital expenditure to total assets per post-issuance year, relative to the value of this ratio as of year  $-1$ . Surprisingly, in each of the three years under consideration, Japanese issuers make significantly smaller increases in capital expenditure, compared with their U.S. counterparts. The difference between Japanese issuers and issuers in developed countries other than the U.S. is only significant during the issuance year.

Overall, Table 8 indicates that Japanese convertible bond issuers are not more likely to use the proceeds for capital expenditure, compared with issuers in other countries. Having ruled out differences in actual uses as a likely explanation for the higher occurrence of capital expenditure as a stated use for Japanese issues, we briefly explore three further non-mutually exclusive reasons for cross-country differences in stated uses of proceeds.

## 5.2 Differences in disclosure standards between Japan and the U.S.<sup>11</sup>

Japanese issuers' higher likelihood of stating capital expenditure as an intended use of proceeds could be caused by cross-country differences in disclosure standards for stated uses of proceeds of security offerings. We focus our analysis on disclosure standards in the U.S. and Japan. As is clear from Table 1, these countries account for 86.6% of the convertible bond issues in our sample.

Rules for disclosure of uses of proceeds of U.S. security offerings are provided in the Securities and Exchange Commission (SEC)'s Securities Act of 1933, as well as in Regulation S-K item 504 (§229.504). Regulation S-K is a regulation under the Securities Act of 1933 that lays out reporting requirements for various SEC filings used by public companies. It is a component of the SEC's 'integrated disclosure system' established in 1982 (which coincides with the start of our sample period) following thorough analysis of the disclosure rules under the Securities Act. We have copied relevant extracts from these regulations in Appendix II of the paper, using italics to emphasize certain relevant elements. As is clear from the Appendix, the Securities Act calls for firms to report the specific purposes of their offerings in detail, as well as state the approximate amounts to be devoted to such purposes, *so far as determinable*. Regulation S-K, in turn, mentions that "(...) details of proposed expenditures need *not* be given; for example, there need be furnished only a brief outline of any program of construction or addition of equipment." As noted by Cohen et al. (2015), security offerings made under Rule 144a (which account for 52.5% of the U.S. convertibles in our sample) typically adopt these same rules when disclosing uses of proceeds.

For Japanese issues, our search was more complicated due to language barriers. We were directed to Chapter III of the rule book of the Japan Securities Dealers Association

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<sup>11</sup> We would like to thank an anonymous referee for suggesting this analysis to us.

(JSDA), which outlines requirements for stated uses of proceeds that underwriters should impose onto issuers. A comparison of these requirements (also copied in Appendix II) with the rules for U.S. firms suggests that, although both U.S. and Japanese regulations mandate disclosure of the intended use of proceeds, U.S. issuers seem to have more leeway regarding the level of detail in the disclosure. That is, the specificity of use of proceeds disclosure is voluntary in nature for U.S. firms (Leone et al., 2007). Japanese firms appear to have less flexibility on this matter, as the Japanese rules do not seem to allow for situations where the firm has no explicit plans yet for the offering proceeds, or does not want to disclose such plans. Thus, cross-country differences in standards of reporting stated uses of proceeds, albeit subtle, could be a driver of our finding that U.S. firms more often provide vague uses of proceeds than their Japanese counterparts.

### *5.3 Firm-specific motives for disclosing non-specific uses of proceeds*

Japanese firms may have rational incentives to state more specific uses of proceeds compared with other firms. We consider three rationales for the level of specificity in security offerings' stated uses of proceeds (Leone et al., 2007). A first rationale is Verrecchia's (1983) *proprietary costs of disclosure* hypothesis. This hypothesis predicts that firms will be less likely to disclose certain types of information if this could reveal valuable proprietary information to their competitors. Applied to our research question, this means that firms may be less likely to mention capital expenditure as a motivation for their offering if this would reveal valuable private information to their competitors, such as news regarding impending production capacity expansions. Firms may instead opt to state general purposes in order to keep competitors in the dark about their investment plans. In other words, Japanese convertible bond issuers may be more likely to include capital expenditure as a stated offering intention because they have smaller proprietary costs of disclosure than their



counterparts in the U.S. and the rest of the developed world. Consistent with Leone et al. (2007), we construct a ‘high tech’ industry dummy defined as in Loughran and Ritter (2004), with high technology (high tech) firms assumed to face higher costs of disclosing proprietary information. We find that the proportion of high tech firms among Japanese convertible bond issuers is higher than in the other subsamples (30.12% for Japan, compared with 13.29% for the U.S. and 15.89% for other developed countries). This result is inconsistent with the notion that Japanese issuers have lower proprietary costs of disclosure. Moreover, as shown in Table 7, Column (3), our main findings are robust to including a high tech industry dummy in the treatment effects regression. The high tech dummy is not significantly related to firms’ decision to report capital expenditure as a stated use, and its inclusion in the second stage regression does not affect our key findings.

A second potential rationale for cross-sectional differences in the specificity of intended uses of proceeds relates to *agency costs*. Providing specific instead of vague intended uses of proceeds may assure capital providers that the funds are used for shareholder wealth enhancing purposes (Mahoney, 1995). Such assurance towards investors may be more valuable for firms that suffer from high agency costs. It is unclear, a priori, whether Japanese firms suffer from higher agency costs than non-Japanese firms. On the one hand, Japanese managers may be more strongly focused on long-term value-enhancing goals instead of short-term goals, leading to lower agency costs. On the other hand, Japanese managers may have a tendency to focus on market share rather than shareholder value (Kang and Stulz, 1996), leading to higher agency costs. Looking at our own sample, slack resources are an often-used proxy for firms’ incentives to spend funds on wasteful projects, and thus for the agency costs associated with an offering (De Jong and Veld, 2001). Table 3, which we discussed earlier, shows that slack resources are not significantly different between Japanese and U.S. issuers, and Column (1) of Table 6 shows that slack does not positively affect firms’ propensity to

state capital expenditure as an intended use for the offering. Thus, the agency costs hypothesis receives little support from our data.

Dye (1985) shows how incomplete disclosure can also derive from *ex ante uncertainty* regarding whether the firm's manager possesses specific proprietary information. Applied to our research design, this may imply that managers refrain from stating specific uses of proceeds because they do not know yet how they will use the proceeds, or because the riskiness of their business is such that they require spending flexibility (Leone et al., 2007). Consistent with this interpretation, we find that stock return volatility, a proxy for *ex ante* risk, is significantly higher for U.S. than for Japanese issuers (Table 3). Moreover, Table 6 shows that stock return volatility has a negative impact on the likelihood of stating capital expenditure as a use of proceeds, which is consistent with what we would expect under Dye's (1985) rationale (i.e. firms with less *ex ante* risk are more likely to cite specific uses of proceeds such as capital expenditure).

In addition to these three rationales for imperfect disclosure, we consider the possibility that the catchall phrase 'general purposes' reflects opportunistic timing motives for security offerings (Autore et al., 2009). U.S. firms may be more likely to time their equity-linked offerings following good stock price performance without having a direct purpose for the offering such as an immediate need to finance capital expenditure, and instead cite vague purposes to motivate their offering. However, it seems unlikely that nearly 85% of U.S. convertibles (as per Table 2) are motivated by such opportunistic reasons. Moreover, our findings on actual uses of proceeds in Table 8 suggest that U.S. firms citing general purposes observe significant increases in asset size, capital expenditure, and research and development following their offering, indicating that these firms did in fact have particular investments in mind when obtaining convertible debt financing. Therefore, we do not believe that issuer

opportunism is the major reason for U.S. issuers' tendency to use 'general purposes' that often.

#### *5.4 SDC's reporting of stated uses of proceeds*

Autore et al. (2009) suggest that SDC has a tendency to report 'general corporate purposes' even though the company cites more specific purposes in its actual offering announcement or prospectus. If SDC's reporting is more accurate for Japanese convertibles than for non-Japanese issues, for example due to the fact that it is done by a different team of coders, then this could also explain why we find a higher percentage of general uses of proceeds for non-Japanese issues. Unfortunately, manually looking up uses of proceeds for all issues in our sample is not possible for the following reasons. First, unlike Walker and Yost (2008), Autore et al. (2009), and Walker et al. (2015), who all use manually collected uses of proceeds information for U.S. SEOs retrieved from the SEC's EDGAR system, we have a cross-country sample. Second, our sample starts in 1982, while EDGAR only systematically provides stated uses as of 1997 (Autore et al., 2009). Third, our sample is much larger than samples used in studies relying on manually collected uses of proceeds data. We perform two tests to assess the likelihood of our findings being affected by reporting issues with stated uses of proceeds in SDC. In a first test, we examine the overall correspondence between stated uses of proceeds obtained from SDC and stated uses of proceeds directly obtained from filings made by the issuer, through the following analysis. We select 20 observations per use of proceeds from SDC (i.e. 20 issues that state capital expenditures as use of proceeds, 20 issues that state debt refinancing as use of proceeds, etc.), excluding the 'general purposes' category which is examined in the next test. We then examine whether these stated uses of proceeds correspond to the use of proceeds in the manually collected issue filings obtained from EDGAR. We find that this correspondence is

95.0%. The conclusion of this analysis is that the classifications of SDC are often accurate provided that SDC indicates a stated use of proceeds other than general corporate purposes. We also examine the proportion of these issues that report information on capital expenditures in their issue filings, even though SDC did not report capital expenditures as a use of proceeds. We find that 22.5% of these observations provide some information on capital expenditures in their issue filings. This percentage does not increase when we also search for issue-related capital expenditure information in Factiva or Google.

Given the popularity of general purposes as a stated use of proceeds category for U.S. issues, our second test focuses on U.S. convertibles for which SDC mentions general purposes as their only stated use of proceeds. There are 697 such convertibles in our final data set. For 150 of these convertibles, we manually look up the actual stated uses of proceeds through EDGAR.<sup>12</sup> We find that SDC's reporting of general purposes can be inaccurate. More particularly, the company effectively states general (corporate) purposes as its use of proceeds in only 71.3% of the 150 cases, and in only 3.33% of the 150 convertibles that we examine does the company mention general (corporate) purposes as its *only* use of proceeds. SDC seems to have a tendency of recording general corporate purposes as the stated use for issues that report many different uses at the same time. Our main concern is that SDC incorrectly codes stated uses for U.S. convertibles as general corporate purposes whilst the company actually mentions capital expenditure as a potential use. For 22.0% of the 150 convertibles that we examine for this second test, companies indeed mention capital expenditures as part of their stated uses of proceeds, but often only as an example of general corporate purposes.

Based on the results of these additional tests, we conclude that the percentage of U.S. issuers who actually mention capital expenditure as a purpose of their offering is likely to be

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<sup>12</sup> These 150 convertibles have all been issued between 1997 and 2003.

higher than the percentage obtained through our use of stated uses of proceeds data obtained from SDC. More particularly, across our two different tests, we consistently find that approximately 22% of the U.S. convertible offerings report some information on capital expenditures while this goes undetected by SDC. When added to the 4.6% of capital expenditure-related stated uses for U.S. convertibles detected by SDC (as per our Table 2), the resulting percentage is still substantially smaller than the 76.4% of capital expenditure-related stated uses recorded for Japanese convertibles.

## **6. Conclusion**

In this paper, we are the first to formally test potential explanations for the less negative stock price reactions for Japanese convertibles, compared with convertibles issued in the U.S. and other developed countries. We study a cross-country sample of convertible bond issues, including Japanese and U.S. firms, which account for the majority of convertible issues. Next to issuer-, issue-, and market-specific determinants suggested by prior work, we also consider differences in the stated uses of proceeds of Japanese convertibles and convertibles issued in other countries.

Our event study results show that over the period 1982-2012, average cumulative abnormal stock returns associated with Japanese convertible bond announcements, while negative, are 2.38% higher than those of convertible bonds issued by U.S. firms, and 0.63% higher than those of convertible bonds issued by firms in other developed countries. Our evidence suggests that the more favorable announcement effects for Japanese convertibles are caused by the fact that Japanese firms are more likely to state that they will use convertible bonds to finance capital expenditures, compared with firms in other countries. Convertibles issued with capital expenditure as a stated purpose on average have more positive stock price reactions.

We explore a number of non-mutually exclusive explanations for Japanese convertible issuers' stronger tendency to include capital expenditure as a stated use of proceeds for the offering. We test whether the differences in stated uses reflect differences in actual uses of convertible bond proceeds across countries. Surprisingly, our analysis indicates that U.S. convertible issuers realize larger increases in capital expenditure following convertible bond issues, compared with Japanese issuers. In fact, U.S. issuers have strongly significant increases in capital expenditure irrespective of the stated use of the offering. Thus, U.S. issuers seem to under-report capital expenditure as a use of proceeds for their convertible bond issue. Further, we examine differences in disclosure standards for intended uses of proceeds of security offerings in Japan versus the U.S. Our analysis suggests that Japanese disclosure standards require a higher level of detail on stated uses of proceeds than U.S. standards. Accordingly, the link between reported and actual uses of proceeds seems strongest in Japan. Although we acknowledge that our analysis of disclosure standards is exploratory in nature, we do believe that differences in disclosure standards might at least be partially driving our findings. Our simple supplemental tests also provide some evidence for the risk uncertainty rationale of Dye (1985) as a possible explanation for the lower specificity in stated uses of proceeds for U.S. firms.

Our analysis is not without limitations. First, we rely on stated uses of proceeds obtained from SDC, rather than on manually collected uses of proceeds, due to the cross-country nature, sample period, and size of our data set. An analysis of manually collected uses of proceeds for a subset of convertibles suggests that inaccuracies in SDC may result in a too low (high) percentage of capital expenditure (general purposes) recorded as stated uses for U.S. convertibles. However, the extent of these errors seems too small for them to be responsible for our key findings. We would encourage further research based on manually collected uses of proceeds. Second, we focus only on convertible bonds as a security type. It

would be interesting to analyze cross-country differences in stated uses of proceeds for seasoned equity and straight bonds as well, and to verify to what extent such differences can explain any differences in stock price reactions.

Overall, our findings suggest that, although U.S. disclosure standards do not require a high level of detail for stated uses of proceeds, U.S. convertible bond issuers might benefit from citing more specific intended uses for their offering. Our results indicate that the market perceives the inclusion of capital expenditure as a stated use of proceeds as a positive signal. Given that many U.S. firms effectively appear to use convertibles for this purpose, they seem to be incurring an overly harsh stock market penalty by not mentioning these intentions as of their offering's announcement date. Perhaps these issuers act under the incorrect belief that the market does not care about stated uses of offering proceeds. On a practical level, we therefore hope that our findings will help firms to make more informed decisions regarding the nature and specificity of the uses of proceeds cited for their security offerings. Our results could also be relevant for investors, by showing that there is often a disconnection between stated and actual uses of proceeds. More particularly, for U.S. convertible bond issues, 'general purposes' as a stated use tends to be associated with significant increases in capital expenditure. Finally, our results could also be of interest to policy makers when setting standards regarding the level of detail required for stated uses of proceeds of security offerings.

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**Table 1. Annual issue numbers and proceeds for convertible bond offerings**

Year	Japan		U.S.		Other countries	
	Number	Proceeds	Number	Proceeds	Number	Proceeds
1982	17	1.00	0	0.00	0	0.00
1983	28	2.20	0	0.00	0	0.00
1984	42	3.25	0	0.00	0	0.00
1985	65	4.90	30	1.66	0	0.00
1986	79	10.28	46	2.72	0	0.00
1987	145	24.12	36	3.81	0	0.00
1988	121	27.54	11	1.09	0	0.00
1989	139	34.40	15	1.12	0	0.00
1990	45	11.69	11	1.55	0	0.00
1991	51	7.75	17	2.27	2	0.25
1992	25	2.72	30	3.53	0	0.00
1993	84	13.47	20	1.78	1	0.15
1994	127	22.84	7	1.14	4	0.43
1995	47	7.44	5	1.32	1	0.35
1996	121	23.92	23	4.36	0	0.00
1997	22	1.64	17	3.07	0	0.00
1998	14	0.77	12	2.70	1	2.37
1999	28	2.83	8	1.57	6	2.20
2000	38	3.11	30	13.02	4	2.67
2001	39	3.12	79	28.38	24	12.69
2002	33	6.43	54	13.75	22	6.70
2003	58	7.19	160	42.02	32	6.57
2004	127	13.84	99	18.04	30	3.77
2005	100	5.97	68	14.92	22	3.04
2006	98	18.33	87	37.89	31	5.06
2007	44	4.72	86	33.19	60	5.22
2008	14	6.40	40	10.83	39	1.22
2009	22	7.16	51	15.42	71	12.27
2010	16	3.54	35	12.48	40	2.45
2011	8	3.55	33	9.17	47	3.23
2012	9	1.04	9	4.13	16	2.75
Total	1,806	287.15	1,119	286.93	453	73.40

*Notes:* This table reports annual issuance numbers and U.S. dollar proceeds (in billions) for convertible bonds issued by firms in Japan, the U.S., and other developed countries across the sample period. Data are obtained from SDC.

**Table 2. Stated uses of proceeds for convertible bond issues**

Country	Capital expenditure		Debt refinancing		Acquisition		Working capital		General purposes	
	%	N	%	N	%	N	%	N	%	N
Japan	74.6	1,347	43.4	783	3.4	62	10.5	189	3.8	68
U.S.	4.6	51	30.7	344	14.5	162	10.2	114	84.6	947
Other countries	14.1	64	14.6	66	10.6	48	38.4	174	62.5	283
Total	43.3	1,462	35.3	1,193	8.1	272	14.1	477	38.4	1,298

*Notes:* This table reports stated uses of proceeds (obtained from SDC) for convertibles issues in Japan, U.S., and other developed countries. Capital expenditure indicates that the stated use of proceeds includes capital expenditure or related terms; Debt refinancing indicates that the stated use of proceeds includes debt refinancing or related terms; Acquisition indicates that the stated use of proceeds includes acquisition; Working capital indicates that the stated use of proceeds includes working capital; and General purposes indicates that the stated use of proceeds includes general (corporate) purposes. The sum of the percentages of stated uses for each of the three subsamples (obtained by summing percentages across each row) is larger than 100%, because several offerings include more than one stated use of proceeds

**Table 3. Summary statistics for convertible bond issuers**

Variable	Japan (N= 1,806)		U.S. (N=1,119)		Other countries (N=453)		<i>t</i> -statistics		
	Mean	Median	Mean	Median	Mean	Median	Japan vs. U.S.	Japan vs. Other countries	U.S. vs. Other countries
Total assets	2,895.86	834.21	3,326.50	625.06	4,494.78	85.84	-0.91	-3.07 <sup>***</sup>	-1.20
Debt/TA	25.81	22.09	27.06	25.72	19.08	16.52	-1.72 <sup>*</sup>	6.83 <sup>***</sup>	7.44 <sup>***</sup>
Stock run-up	4.27	3.37	15.03	11.33	11.40	5.70	-9.97 <sup>***</sup>	-5.49 <sup>***</sup>	1.73 <sup>*</sup>
Market run-up	2.47	2.06	4.00	4.27	3.83	4.13	-4.91 <sup>***</sup>	-2.68 <sup>***</sup>	0.34
Stock return volatility	40.49	35.82	57.05	46.34	78.40	63.65	-14.95 <sup>***</sup>	-24.68 <sup>***</sup>	-8.54 <sup>***</sup>
Market return volatility	16.83	17.12	17.22	14.59	20.86	19.35	-1.52	-12.32 <sup>***</sup>	-7.81 <sup>***</sup>
Slack/TA	19.89	17.02	20.36	12.07	17.18	11.05	-0.73	3.61 <sup>***</sup>	2.79 <sup>***</sup>
Proceeds/TA	0.13	0.09	0.31	0.20	0.26	0.11	-21.27 <sup>***</sup>	-12.16 <sup>***</sup>	2.59 <sup>***</sup>
Maturity	7.61	7.24	16.28	10.16	5.97	4.47	-20.60 <sup>***</sup>	4.65 <sup>***</sup>	11.47 <sup>***</sup>

*Notes:* This table reports the mean and median values of firm and convertible bond issue characteristics for Japan, the U.S., and the other developed countries included in the sample. A detailed definition of variables can be found Appendix I. Total assets are in millions of U.S. dollars. N denotes number of observations. *t*-statistics are reported to demonstrate the significance of the differences in mean values between each subsample. \*, \*\*, and \*\*\* represent significance at the 10%, 5% and 1% significance level, respectively.



**Table 4. Stock price reactions around convertible debt announcements**

<i>Panel A</i>						
Country	N	Mean	Median	Std. Dev.	<i>t</i> -statistics	Wilcoxon statistics
Australia	198	-0.26%	-0.12%	8.54%	-0.44	-0.19
Canada	122	-2.25%	-1.79%	8.23%	-3.02***	-2.84***
France	72	-2.48%	-2.65%	5.07%	-4.11***	-3.87***
Germany	21	-3.01%	-3.12%	6.25%	-2.20**	-1.72*
Japan	1,806	-0.80%	-0.79%	6.15%	-5.52***	-5.55***
Netherlands	16	-2.06%	-0.27%	7.67%	-1.07	-0.52
Switzerland	13	-3.01%	-3.50%	5.65%	-2.11**	-1.92*
U.K.	12	-0.30%	-1.27%	8.19%	-0.13	-0.24
U.S.	1,119	-3.18%	-3.15%	7.45%	-14.27***	-13.22***

<i>Panel B</i>				
Countries	Mean difference	Median difference	<i>t</i> -statistics	Wilcoxon statistics
Japan-U.S.	2.38%	2.36%	9.37***	9.44***
Japan-Other countries	0.63%	0.30%	1.83*	1.57
Other countries-U.S.	1.75%	2.06%	4.16***	4.21***

*Notes:* This table presents cumulative abnormal returns (CAR) around convertible bond announcements for Japan, the U.S., and the other developed countries included in the sample. Cumulative abnormal stock returns are measured over the window (-1, 1) relative to the announcement date, using a market model estimated over trading day -250 to -10. Panel A reports the mean, median, and standard deviation of the CAR, as well as *t*-test and Wilcoxon test statistics assessing whether the CAR are significantly different from zero. Panel B tests whether the differences in the mean and median CAR between countries are statistically significant, using *t*-test and Wilcoxon test statistics. \*, \*\*, and \*\*\* represent significance at the 10%, 5% and 1% significance level, respectively.

**Table 5. Determinants of stock price reactions around convertible bond announcements**

Variables	(1)	(2)
Japan dummy	0.885*** (3.099)	1.455*** (4.352)
LnTA		-0.254*** (-3.100)
Debt/TA		-0.008 (-1.022)
Stock run-up		0.025*** (4.349)
Market run-up		0.006 (0.382)
Stock return volatility		-0.014** (-2.468)
Market volatility		0.077** (2.543)
Slack/TA		-0.007 (-0.931)
Proceeds/TA		-0.307 (-0.833)
Maturity		0.017 (1.267)
Short selling dummy		-1.137 (-1.129)
Keiretsu dummy		-0.491 (-1.535)
Constant	-2.146*** (-11.104)	1.322 (0.857)
N	3,378	3,378
Adj. R <sup>2</sup>	0.037	0.055

Notes: This table presents the results of regression analyses of stock price reactions around convertible bond announcements. The dependent variable is the cumulative abnormal stock return (CAR) measured over the window (-1, 1) relative to the announcement date, calculated using market model regressions with estimation period from trading day -250 to -10. The table reports OLS regressions with White-corrected standard errors. Year dummies are included but not reported. Detailed definitions of variables can be found in Appendix I. *t*-statistics are reported in parentheses. N denotes the number of observations. \*, \*\*, and \*\*\* represent significance at the 10%, 5% and 1% significance level, respectively.

**Table 6. Determinants of stock price reactions to convertible bond announcements, including treatment effects** <sup>42</sup>

Variables	(1)		(2)	
	1st stage: Capital expenditure dummy	2 <sup>nd</sup> stage: CAR	1st stage: Capital expenditure dummy	2 <sup>nd</sup> stage: CAR
Japan dummy	1.952 <sup>***</sup> (18.421)	-1.527 (-1.389)	2.616 <sup>***</sup> (15.149)	-1.476 (-1.321)
Capital expenditure dummy		5.603 <sup>***</sup> (2.891)		5.462 <sup>***</sup> (2.786)
LnTA	-0.032 (-1.269)	-0.230 <sup>**</sup> (-2.468)	-0.086 <sup>**</sup> (-2.546)	-0.224 <sup>**</sup> (-2.447)
Debt/TA	-0.013 <sup>***</sup> (-6.188)	0.006 (0.572)	-0.015 <sup>***</sup> (-5.919)	0.005 (0.442)
Stock run-up	0.002 (1.002)	0.020 <sup>***</sup> (3.288)	0.000 (0.267)	0.021 <sup>***</sup> (3.427)
Market run-up	0.001 (0.206)	0.019 (0.956)	-0.002 (-0.312)	0.027 (1.357)
Stock return volatility	-0.006 <sup>***</sup> (-3.629)	-0.009 (-1.427)	-0.006 <sup>**</sup> (-2.278)	-0.011 <sup>*</sup> (-1.749)
Market volatility	0.023 <sup>**</sup> (2.517)	0.026 (0.705)	0.040 <sup>***</sup> (3.544)	0.022 (0.576)
Slack/TA	-0.002 (-0.705)	-0.007 (-0.859)	-0.004 <sup>*</sup> (-1.653)	-0.009 (-1.035)
Proceeds/TA	0.563 <sup>*</sup> (1.881)	0.011 (0.007)	0.042 (0.088)	0.860 (0.560)
Maturity	-0.001 (-0.144)	0.015 (1.184)	-0.004 (-0.233)	0.017 (1.296)
Short selling dummy	0.068 (0.257)	-1.014 (-0.986)	0.157 (0.351)	-0.741 (-0.594)
Keiretsu dummy	0.341 <sup>***</sup> (3.311)	-0.817 <sup>*</sup> (-1.747)	0.310 <sup>***</sup> (2.755)	-0.749 (-1.636)
Capital expenditure/TA	0.017 <sup>***</sup> (5.224)		0.020 <sup>***</sup> (4.779)	
Constant	-0.579 (-0.800)	3.170 (1.382)	-0.444 (-0.592)	2.235 (1.073)
N		2,695		2,695
Rho		-0.501 <sup>***</sup>		-0.472 <sup>**</sup>

*Notes:* This table presents the results of regression analyses of stock price reactions around convertible bond announcements. The dependent variable is the cumulative abnormal stock return (CAR) measured over the window (-1, 1) relative to the announcement date, calculated using market model regressions with estimation period from trading day -250 to -10. We use two different definitions of the capital expenditure dummy in specification (1) and (2). In specification (1), the capital expenditure dummy equals one if the stated purpose of proceeds includes capital expenditure or related terms (but may include other uses), while in specification (2), it equals one if the stated purpose of the proceeds includes *only* capital expenditure or related terms (no other uses). We use a treatment effects model with Huber-White sandwich estimators to address potential endogeneity between capital expenditure as a stated use of proceeds and stock price reactions. For each specification, we report both the first and second stage results. Year dummies are included but not reported. Detailed definitions of variables can be found in Appendix I. *t*-statistics are reported in parentheses. N denotes the number of observations. Rho is the correlation coefficient of the errors in the two component equations. \*, \*\*, and \*\*\* represent significance at the 10%, 5% and 1% significance level, respectively.

**Table 7. Robustness tests**

Variables	(1)		(2)		(3)	
	1 <sup>st</sup> stage: Capital expenditure dummy	2 <sup>nd</sup> stage: CAR	1 <sup>st</sup> stage: Capital expenditure dummy	2 <sup>nd</sup> stage: CAR	1 <sup>st</sup> stage: Capital expenditure dummy	2 <sup>nd</sup> stage: CAR
Japan dummy	1.988 <sup>***</sup> (20.425)	-1.513 (-1.605)	1.941 <sup>***</sup> (17.759)	-0.599 (-0.845)	1.937 <sup>***</sup> (17.744)	-1.761 (-1.566)
Cap. expenditure dummy		5.371 <sup>***</sup> (3.562)		3.306 <sup>**</sup> (2.569)		5.626 <sup>***</sup> (2.805)
LnTA	-0.046 <sup>*</sup> (-1.951)	-0.223 <sup>**</sup> (-2.493)	-0.024 (-0.975)	-0.193 <sup>***</sup> (-3.173)	-0.033 (-1.238)	-0.328 <sup>***</sup> (-3.304)
Debt/TA	-0.013 <sup>***</sup> (-6.570)	0.007 (0.733)	-0.010 <sup>***</sup> (-4.561)	0.002 (0.280)	-0.013 <sup>***</sup> (-6.185)	0.006 (0.595)
Stock run-up	0.001 (0.550)	0.022 <sup>***</sup> (3.375)	0.003 <sup>*</sup> (1.819)	-0.013 <sup>***</sup> (-3.281)	0.002 (1.098)	0.021 <sup>***</sup> (3.370)
Market run-up	-0.001 (-0.220)	0.007 (0.396)	-0.002 (-0.429)	0.045 <sup>***</sup> (3.795)	0.003 (0.662)	0.016 (0.790)
Stock return volatility	-0.006 <sup>***</sup> (-3.558)	-0.010 <sup>*</sup> (-1.681)	-0.005 <sup>***</sup> (-3.395)	0.001 (0.205)	-0.006 <sup>***</sup> (-3.626)	-0.011 <sup>*</sup> (-1.723)
Market volatility	0.024 <sup>***</sup> (2.763)	0.050 (1.542)	0.017 <sup>*</sup> (1.773)	0.021 (0.916)	0.020 <sup>**</sup> (2.073)	0.031 (0.838)
Slack/TA	-0.001 (-0.567)	-0.008 (-1.016)	-0.002 (-0.913)	-0.009 (-1.494)	-0.002 (-0.960)	-0.003 (-0.351)
Proceeds/TA	0.353 (1.221)	0.357 (0.219)	0.491 <sup>*</sup> (1.712)	-1.554 (-1.540)	0.106 (0.634)	-1.600 <sup>**</sup> (-2.069)
Maturity	0.002 (0.271)	0.016 (1.139)	-0.002 (-0.315)	0.001 (0.144)	-0.001 (-0.159)	0.014 (1.064)
Short selling dummy	0.018 (0.072)	-1.038 (-1.015)	-0.026 (-0.107)	-0.729 (-1.147)	0.073 (0.280)	-1.087 (-1.058)
Keiretsu dummy	0.317 <sup>***</sup> (3.488)	-0.848 <sup>**</sup> (-2.325)	0.321 <sup>***</sup> (3.155)	-0.559 <sup>**</sup> (-2.070)	0.339 <sup>***</sup> (3.228)	-0.714 (-1.489)
High tech					-0.058 (-0.635)	0.555 (1.485)
Capital expenditure/TA			0.018 <sup>***</sup> (6.036)		0.017 <sup>***</sup> (5.181)	
Net assets growth	0.007 <sup>**</sup> (2.321)					
Constant	-1.580 <sup>***</sup> (-2.809)	-0.612 (-0.290)	-0.557 (-0.788)	2.168 (1.587)	-0.491 (-0.660)	4.775 <sup>**</sup> (2.012)
N		2,695		2,695		2,695
Rho		-0.483 <sup>***</sup>		-0.468 <sup>**</sup>		-0.500 <sup>***</sup>

*Notes:* This table presents the results of regression analyses of stock price reactions around convertible bond announcements, testing the robustness of the results displayed in Table 6. The dependent variable is the cumulative abnormal stock return (CAR) measured over the window (-1, 1) relative to the announcement date, calculated using market model regressions with estimation period from trading day -250 to -10. We use a treatment effects model with Huber-White sandwich estimators to address potential endogeneity between capital expenditure as a stated use of proceeds and stock price reactions. In specification (1), we use an alternative instrument (net assets growth) in the first stage probit analysis. In specification (2), we use the CAR calculated over the (-8,1) window instead of the (-1,1) window as dependent variable. In specification (3), we include a high tech dummy defined as outlined in Appendix I as an additional explanatory variable. Year dummies are included but not reported. Detailed definitions of variables can be found in Appendix I. *t*-statistics are reported in parentheses. N denotes the number of observations. Rho is the correlation coefficient of the errors in the two component equations. \*, \*\*, and \*\*\* represent significance at the 10%, 5% and 1% significance level, respectively.

Table 8. Median firm characteristics from the year preceding the issue to two years following the issue

## Panel A

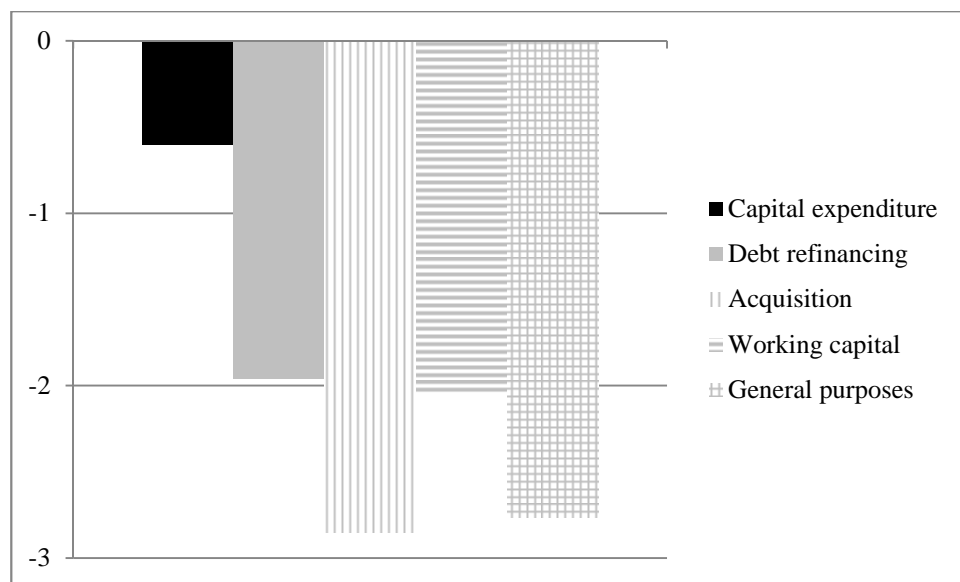
Stated use of proceeds	Firm characteristic	Japan				U.S.				Other countries			
		Yr. -1	Year 0	Year 1	Year 2	Yr. -1	Year 0	Year 1	Year 2	Yr. -1	Year 0	Year 1	Year 2
Capital expenditure	Total assets	1.000	1.053***	1.132***	1.256***	1.000	1.171***	1.536***	2.231***	1.000	1.111***	1.589***	2.520***
	Capital expenditure	0.054	0.056***	0.062***	0.071***	0.065	0.088***	0.113***	0.124***	0.101	0.166***	0.259***	0.269***
	Research & Development	0.023	0.024***	0.025***	0.028***	0.081	0.065***	0.087***	0.082**	0.000	0.000	0.000***	0.000***
	Cash	0.171	0.186***	0.208***	0.244***	0.349	0.328**	0.398***	0.446***	0.158	0.182***	0.230***	0.169***
	Long term borrowing	0.086	0.072	0.077	0.078	0.023	0.088	0.531	0.161	0.0019	0.472	0.124	0.121
	Working capital	0.108	0.111***	0.112***	0.134***	0.604	0.846	0.237	0.080	0.540	0.188**	0.107***	0.049***
Debt refinancing	Total assets	1.000	1.040***	1.349***	1.752***	1.000	1.117***	1.384***	2.231***	1.000	1.143***	1.374***	2.361***
	Capital expenditure	0.011	0.017*	0.019***	0.031***	0.050	0.055***	0.073***	0.099***	0.045	0.061*	0.072***	0.085***
	Research & Development	0.013	0.013**	0.020**	0.017	0.055	0.068***	0.084***	0.076***	0.0028	0.002***	0.002**	0.0029
	Cash	0.194	0.266***	0.330***	0.351***	0.192	0.189***	0.339***	0.312***	0.128	0.141***	0.261***	0.212***
	Long term borrowing	0.049	0.0020*	0.050	0.003	0.030	0.071*	0.037	0.134	0.253	0.193	0.433	0.232
	Working capital	0.306	0.286	0.306	0.281	0.374	0.363	0.424	0.449	0.1111	0.175	0.814	0.401
Acquisition	Total assets	1.000	1.031***	1.083***	1.159***	1.000	1.196***	1.243***	1.662***	1.000	1.072***	1.055***	1.111***
	Capital expenditure	0.037	0.039	0.040	0.046***	0.051	0.053***	0.066***	0.074***	0.060	0.067***	0.046	0.055***
	Research & Development	0.016	0.017***	0.019***	0.017***	0.024	0.028***	0.029***	0.027***	0.014	0.015	0.008***	0.007***
	Cash	0.148	0.156***	0.162***	0.197***	0.072	0.0737	0.115***	0.106***	0.085	0.115	0.099***	0.119***
	Long term borrowing	0.052	0.044	0.065	0.045	0.021	0.042	0.029	0.070	0.0051	0.000	0.004	0.025
	Working capital	0.115	0.112***	0.129***	0.144***	0.131	0.169*	0.185	0.206**	0.215	0.012***	0.144***	0.070***
Working capital	Total assets	1.000	1.006*	1.020**	1.041***	1.000	1.110***	1.168***	1.822***	1.000	1.144***	1.19**	1.48***
	Capital expenditure	0.015	0.018	0.013	0.013	0.033	0.038**	0.042***	0.054***	0.040	0.049**	0.063	0.093
	Research & Development	0.013	0.014	0.015	0.014	0.128	0.149***	0.185***	0.183***	0.012	0.026	0.002	0.000
	Cash	0.132	0.133	0.125	0.154***	0.300	0.300**	0.363***	0.400***	0.163	0.148*	0.127	0.208***
	Long term borrowing	0.054	0.055	0.050	0.057	0.010	0.015	0.000	0.028	0.108	0.307*	0.122	0.152
	Working capital	0.150	0.184*	0.236**	0.259**	0.219	0.300	0.439	0.704	0.370	0.116	0.191**	0.182**
General purposes	Total assets	1.000	1.100***	1.138***	1.251***	1.000	1.100***	1.246***	1.645***	1.000	1.071	1.154***	1.460***
	Capital expenditure	0.047	0.053**	0.044	0.063*	0.046	0.050***	0.053***	0.064***	0.052	0.057***	0.060	0.069*
	Research & Development	0.055	0.057***	0.054***	0.045***	0.067	0.071***	0.078***	0.079***	0.012	0.012***	0.013***	0.016***
	Cash	0.183	0.210	0.207**	0.185**	0.173	0.187***	0.253***	0.272***	0.120	0.131	0.154**	0.186**
	Long term borrowing	0.0008	0.0036	0.008**	0.008	0.097	0.025	0.007	0.014	0.039	0.108***	0.051**	0.104
	Working capital	0.118	0.100	0.023	0.074*	0.249	0.272**	0.260***	0.264**	0.191	0.091	0.120	0.151*

*Panel B*

Countries	Year 0		Year 1		Year 2	
	Difference in median	Wilcoxon test	Difference in median	Wilcoxon test	Difference in median	Wilcoxon test
Japan-U.S.	-0.107	-3.10***	-0.188***	-3.74	-0.344***	-2.88
Japan-Other countries	-0.109	-2.11**	-0.114	-1.38	0.150	1.27
U.S.-Other countries	-0.003	-0.13	0.074	0.85	0.320***	2.65

*Notes:* Panel A reports median firm characteristics (standardized by the book value of total assets in the year preceding the convertible bond issuance) in the year preceding the issue (year -1), the issue year (year 0), and the two years following the issue (years 1 and 2). \*, \*\*, and \*\*\* represent significant differences in the firm characteristics for years 0, 1, and 2 relative to year -1, at the 10%, 5% and 1% confidence levels. Panel B reports differences in the increases of the median capital expenditure/total assets ratio (relative to its value in year -1) between geographic subsamples in year 0, year 1 and year 2. Two-population Wilcoxon rank-sum (Mann-Whitney) tests are used to test the significance of the differences in the median increases.

**Figure 1. Average stock price reactions associated with convertible bond issues by their stated purpose of issue**



*Notes:* This figure illustrates average announcement effects for convertible bond issues by their stated purpose of issue. Average cumulative abnormal stock returns (CAR) over window  $(-1, 1)$  are on the vertical axis. The bars on the horizontal axis represent the stated purpose of convertible issues (obtained from SDC), which are capital expenditure, debt refinancing, acquisition, working capital, and general purposes, respectively (going from left to right).

**Appendix I**

<b>Variable</b>	<b>Classification</b>		<b>Definition</b>
Capital expenditure dummy	Use of proceeds	Thomson's SDC Platinum	1 if the stated uses of proceeds include capital expenditure or related terms, and 0 otherwise
Capital expenditure/TA	Firm-specific	Datastream	Capital expenditure divided by total assets
Debt/TA	Firm-specific	Datastream	Total debt divided by total assets
High tech	Firm-specific	Datastream	1 for high technology firms, and 0 otherwise. We define high technology companies following the SIC codes identified by Loughran and Ritter (2004).
Japan dummy	Market-specific	Datastream	1 for Japanese issues and 0 otherwise
Keiretsu dummy	Firm-specific	2001 Edition of Industrial Groupings in Japan	1 for Japanese firms that are mentioned on the list of 'major group companies' of the 2001 Edition of Industrial Groupings in Japan, Part II C ('Vertically integrated groups'), and 0 for all other Japanese and non-Japanese firms.
LnTA	Firm-specific	Datastream	Natural logarithm of total assets denominated in U.S. dollar
Market return volatility	Market-specific	Datastream	Annualized market return volatility, calculated from daily returns on the S&P 500 index over the window (-240,-40) relative to the convertible bond announcement date
Market run-up	Market-specific	Datastream	Return on the S&P 500 index over the window (-60,-2) relative to the announcement date
Maturity	Issue-specific	Datastream	Convertible bond maturity, measured as of the issue date
Net asset growth	Firm-specific	Datastream	The growth of the book value of equity, measured over the fiscal year prior to issuance
Proceeds/TA	Issue-specific	Datastream	Relative size of the convertible bond offering, calculated as the offering proceeds divided by total assets
Short selling dummy	Market-specific	De Jong et al. (2012)	1 for the sample countries allowing short selling, and 0 for the sample countries having a short selling ban in place on the date of the convertible debt issuance. We assume that there are no short selling bans before 1990, the start of De Jong et al (2012)'s sample period, and after 2009, the end of their sample period, except for France and Germany who still had short sale bans in place after 2009.
Slack/TA	Firm-specific	Datastream	Cash and short-term investments divided by total assets
Stock return volatility	Firm-specific	Datastream	Annualized stock return volatility, calculated from daily stock returns over the window (-250,-10) relative to the convertible bond announcement date
Stock run-up	Firm-specific	Datastream	Stock return over the window (-60,-2) relative to the announcement date



## Appendix II: Relevant extracts from rules for disclosure of stated uses of proceeds

This Appendix provides relevant rules regarding disclosures of intended uses of proceeds of security offerings for the U.S. and Japan. The extracts are copied directly from the relevant Acts and Rules. We have indicated some interesting parts in italics. All of these sources are publicly available on the web.

### II-1. United States

*Schedule A of the SEC's 1933 Securities Act:*<sup>13</sup>

“(13) the specific purposes in detail and the approximate amounts to be devoted to such purposes, *so far as determinable*, for which the security to be offered is to supply funds, and if the funds are to be raised in part from other sources, the amounts thereof and the sources thereof, shall be stated;”

*Regulation S-K, item 504:*

“State the principal purposes for which the net proceeds to the registrant from the securities to be offered are intended to be used and the approximate amount intended to be used for each such purpose. *Where the registrant has no current specific plan for the proceeds, or a significant portion thereof, the registrant shall so state* and discuss the principal reasons for the offering.

Instructions to Item 504: 1. Where less than all the securities to be offered may be sold and more than one use is listed for the proceeds, indicate the order of priority of such purposes and discuss the registrant's plans if substantially less than the maximum proceeds are obtained. Such discussion need not be included if underwriting arrangements with respect to such securities are such that, if any securities are sold to the public, it reasonably can be expected that the actual proceeds will not be substantially less than the aggregate proceeds to the registrant shown pursuant to Item 501 of Regulation S-K (§ 229.501).

2. *Details of proposed expenditures need not be given*; for example, there need be furnished only a brief outline of any program of construction or addition of equipment. Consideration should be given as to the need to include a discussion of certain matters addressed in the discussion and analysis of registrant's financial condition and results of operations, such as liquidity and capital expenditures.

3. If any material amounts of other funds are necessary to accomplish the specified purposes for which the proceeds are to be obtained, state the amounts and sources of such other funds needed for each such specified purpose and the sources thereof.

4. If any material part of the proceeds is to be used to discharge indebtedness, set forth the interest rate and maturity of such indebtedness. If the indebtedness to be discharged was incurred within one year, describe the use of the proceeds of such indebtedness other than short-term borrowings used for working capital.

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<sup>13</sup> [www.sec.gov](http://www.sec.gov)

5. If any material amount of the proceeds is to be used to acquire assets, otherwise than in the ordinary course of business, describe briefly and state the cost of the assets and, where such assets are to be acquired from affiliates of the registrant or their associates, give the names of the persons from whom they are to be acquired and set forth the principle followed in determining the cost to the registrant.

6. Where the registrant indicates that the proceeds may, or will, be used to finance acquisitions of other businesses, the identity of such businesses, if known, or, if not known, the nature of the businesses to be sought, the status of any negotiations with respect to the acquisition, and a brief description of such business shall be included. Where, however, pro forma financial statements reflecting such acquisition are not required by Regulation S-X (17 CFR 210.01 through 210.12-29), including Rule 8-05 for smaller reporting companies, to be included in the registration statement, the possible terms of any transaction, the identification of the parties thereto or the nature of the business sought need not be disclosed, to the extent that the registrant reasonably determines that public disclosure of such information would jeopardize the acquisition. Where Regulation S-X, including Rule 8-04 for smaller reporting companies, as applicable, would require financial statements of the business to be acquired to be included, the description of the business to be acquired shall be more detailed.

7. The registrant may reserve the right to change the use of proceeds, provided that such reservation is due to certain contingencies that are discussed specifically and the alternatives to such use in that event are indicated.”

*Common practice for Rule 144a offerings (Cohen et al., 2015):*

*“The disclosure document in a Rule 144A offering is typically modeled after a public offering prospectus. This holds true for financial statement requirements as well – although the line item disclosure rules of the Securities Act do not strictly apply to private offerings under Rule 144A, it has become standard practice to follow these rules as if they applied to Rule 144A offerings, with only limited exceptions. In many situations, the commitment committees of the major financing sources will insist on including financial disclosure in the Rule 144A offering circular that is in all material respects consistent with the financial statement requirements that would apply to a registration statement filed with the SEC. Rule 144A offerings are typically sold off the desk to buyers who expect substantially the same level of disclosure that they would receive in a public deal. Additionally, in the case of a Rule 144A offering with registration rights, the Rule 144A circular will be followed by a registered exchange offer prospectus and the buyers of the offered securities will thereby receive full Securities Act disclosure after the closing. Therefore, Rule 144A offering circulars typically follow the public offering rules described above in all material respects.”*

## **II-2. Japan**

*Japan Securities Dealers Association (JSDA) rule book, Chapter III:*<sup>14</sup>

“Article 20: When a Lead Managing Regular Member Underwriter underwrites a public offering of Share Certificates, etc., it must request the issuer to report its cash flow, etc. for the purpose of confirming the purpose of use of funds raised by the public offering and its effect, and to publicize the matters prescribed in each Item below to clarify the purpose of use

<sup>14</sup> <http://www.jsda.or.jp/en/rules/content/140101E41.pdf>

of funds to be raised in the press release materials prescribed in the Detailed Rules (hereinafter referred to as “Press Release Materials”): 13 (1) Purpose of use of the funds to be raised; *Disclosure of specific contents, amount and time of payment for each item such as equipment investment, repayment of loans and investment/financing, etc.* (2) Effects of the funds to be raised on the future profits of the issuer; Specific and, to the extent possible, quantitative disclosure (if the disclosure is made on certain assumptions, such fact shall be described).”