FIRM CHARACTERISTICS INFLUENCING GROWTH OPPORTUNITIES: EMPIRICAL EVIDENCE FROM THE EMERGING MARKET OF THAILAND

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Abstract: This study examines the firm characteristics that affect growth opportunities of Thai listed firms. The firms' growth opportunities in the emerging market are important as those firms need more capital to raise future investment; however, Thai firms experience severe agency problems due to weak legal investor protection and ownership concentration. This study finds that Thai firms with higher information asymmetry and larger market share tend to have lower growth opportunities. However, the findings further show that investors expect higher growth for firms with higher stock liquidity and larger size.

Key words: Growth Opportunities, Emerging Market

I. INTRODUCTION

The value of firms consists of the values from assets-in-place and growth opportunities, the latter of which account for a significant portion of the firms' market value (Myers (1977)). Previous research reports that investors generally focus on the value of growth opportunities when making a price assessment of an initial public offering (Chung, Li, and Yu (2005)). Studying on the determinants of firm growth is appealed because investors need information about the firms to predict a valuable stock. In particular, the firms in emerging markets such as those in Thailand need more foreign fund flows to raise new capital expenditures but growth is impeded by severe agency conflicts (Standford (2002); Gorkittisunthorn, Jumreornwong, and Limpaphayom (2006)). Therefore, Thailand offers interesting contrasts to the develop markets, e.g. the US, as environment to examine the determinants of growth opportunities.

This research aims to investigate the firm characteristics influencing growth opportunities of Thai listed firms. The regression results show that growth opportunities are negatively associated with information asymmetry and market share the firm owns,and positively associated with stock turnover and firm size. These findings suggest that the existence of private information of Thai emerging market as reflected by larger bid-ask spreads likely induce agency problems and hence inhibiting future business expansion. While, the market leaders whose product life cycles are matured are less likely to additionally invest for the new projects. Moreover, Thai firms with higher stock liquidity enjoying the lower costs of equity capital and larger size incurring new capital expenditures will have more investment opportunities.

This study contributes to corporate finance and accounting literature by providing the first evidence on the determinants of growth opportunities of Thai emerging market. The findings of this study can be applied to other economies with similar settings in which growth opportunities are essential but agency problems are unique and complex.These findingsare also beneficial to financial users of the capital markets, e.g. investors, creditors, to evaluate firms' growthor make a decision about lending.

II. LITERATURE REVIEW AND HYPOTHESES

Myers (1977) defines growth opportunities to a significant part of firm value. In the theoretical work, he argues that a firm value consists of the values from assets-in-place and growth opportunities. In industries with high demand volatility, Kester (1984) and (1986) report that the proportions of the market value of a firm's equity accounted for by growth opportunities are approximately 70-80 percent of the firm's equity value. Chung et al. (2005) argue that growth opportunities play a more dominating role than assets-in-place in determining initial public offering prices as investors equate one dollar of growth opportunity to roughly three quarters of firms' assets.

To create the firms' future growth it is subject to many factors. Christies (1989) argues that the value of each firm's growth opportunities is different, depending upon both industry- and firm-specific factors. The former is the primary determinants of growth opportunities involving the industrial advantages presented to the firm, e.g. barriers to entry or product lifecycles, which lead to competitive advantages and increase the value of the firm. The latter reflects the firm's characteristics or ability that contributes to more opportunity to invest. Despite various factors influencing future growth, investors need information that helps them estimate the value of growth opportunities and hence the firms' values.

The divergence of interests in firms stems from the principal-agent relationships between managers and

shareholders (agency conflict type I) and between inside and outside shareholders (agency conflict type II).

In Thai emerging market where the majority of listed firms are family-owned, information asymmetry tend to severe and the firms experience the agency conflicts both type I and II . Amihud and Mendelson (1986) argue that "the greater the relative private information, the larger the bid-ask spreads, the lower the returns to the uninformed investors, and the higher the equilibrium required returns on the stock". Therefore, the stock price and growth will decrease for the firms with higher asymmetric information and this study hypothesizes that:

[1] The divergence of interests in firms stems from the principal-agent relationships between managers and shareholders (agency conflict type I) and between inside and outside shareholders (agency conflict type II).

H1: Information asymmetry is negatively associated with firms' growth opportunities.

Yoon and Starks (1995) argue that based on the cash flow signaling hypothesis, managers possessing more information about firms' cash flow than do outside investors have an incentive to openly signal that information to the investors. On the one hand, under the free cash flow hypothesis, changes in dividend reflect managers' investment policies given their opportunity set. Dividends will be paid less or not be paid if the managers are presented with new investment projects. Therefore, this study hypothesizes that:

H2: Dividend payouts are positively or negatively associated with firms' growth opportunities.

Becker-Blease and Paul (2006) find a positive correlation between stock turnover and growth opportunities in a sample of S&P500 firms. Investors are willing to pay premium prices for stocks with higher liquidity by asking for lower rates of return on expectations of high growth. Thus, the firms enjoying more liquid equity experience a lower cost of equity. This study hypothesizesthat:

H3: Stock turnover is positively associated with firms' growth opportunities.

Growth opportunities are positively correlated to profitability as they are viewed as the risk-adjusted net present value of expected future profits (Chauvin and Hirschey (1993)). In general, investors rely on the current rate of profitability as the best available indicator of future profits. Thus, large current profits reflect firms' future investment opportunities and hence the investors' expectation of continued future profitability. This study hypothesizes that:

H4: Profitability is positively associated with firms' growth opportunities

Prior study reports a positive relationship between firm size and growth (Chauvin and Hirschey (1993)). The reasons are that larger firms, compared to smaller firms, are in a better position to create and explore new investment opportunities, so future expansion is easily achieved by the large-sized firms. Therefore, this hypothesizes that:

H5: Firm size is positively associated with firms' growth opportunities.

Prior studies argue that firms with a larger market share can create a barrier to entry to new entrants owing to the economies of scale, lower costs of capital, and monopoly in the future economic rents (Christies (1989); Cheng (2005)). Thus, a larger market share allows a firm to retain its growth. Nevertheless, market leaders whose businesses reach the maturity stage of product life cycle are less likely to make additional investment, thereby retarding or inhabiting growth of the businesses. This study hypothesizes that:

H6: Market share is positively or negatively associated with firms' growth opportunities.

III. METHODOLOGY AND EMPIRICAL RESULTS

3.1 Sample Selection and Data

The initial sampleincludes listed firms in the Stock Exchange of Thailand (SET) during the years 2005-2011 from Thomson DataStream database. The sampled firms under rehabilitation, in the financial industry, and without December fiscal year end are removed, leaving the final sample of 1,389 firm-year observations.

3.2 Model Test and Regression Results

The research hypotheses are tested with the regression model (1) below. The model encompasses the firm characteristics influencing growth opportunities and year fixed effects as follows.

$$GROWTH_{i,t} = \alpha_0 + \alpha_1 ASYM_{i,t} + \alpha_2 DIV_{i,t} + \alpha_3 TURN_{i,t} + \alpha_4 PROFIT_{i,t} + \alpha_5 SIZE_{i,t} + \alpha_6 MKSHARE_{i,t} + \alpha_{6+j} \sum_{j=1}^{6} YEAR_j + \varepsilon_{i,t} \quad (1)$$

	Predicted Sign	Estimate Coefficients	p-value[1]
Intercept		-0.2390	0.1566
ASYM	(-)	-0.4558	0.0006***
DIV	(+/-)	-0.0209	0.1927
TURN	(+)	0.0253	0.0011***
PROFIT	(+)	0.0070	0.9497
SIZE	(+/-)	0.0203	0.0055***
MKSHARE	(+/-)	-1.3041	<.0001***
Year Fixed Effects			Yes
Adj.R2			0.0426
F-value			<.0001***
N[2]			1,389

Variable Definitions:

GROWTH is growth opportunities measured by the annual variance of return on market value of assets since 1998. **ASYM** is information asymmetry

calculated by the annual average of the daily ask-bid spreads scaled by closing price. **DIV** is dividend payout captured by the ratio of annual dividend payment to annual earnings before extraordinary items. **TURN** is stock turnover calculated by is the ratio of the number of shares traded to the number of outstanding shares. **PROFIT** is profitability measured by the ratio of annual operating incomes to total assets. **SIZE** is firm size captured by a natural logarithm of annual sale. **MKSHARE** is market share measured by annual revenues divided by total industry revenues. **Year Fixed Effects** include **YEAR06**, a dummy variable coded one if firm i is in year 2006, **YEAR07**, a dummy variable coded one if firm i is in year 2007, **YEAR08**, a dummy variable coded one if firm i is in year 2008, **YEAR09**, a dummy variable coded one if firm i is in year 2009, **YEAR10**, a dummy variable coded one if firm i is in year 2010, and **YEAR11**, a dummy variable coded one if firm i is in year 2011.

Note:
[1] To correct for heteroscadasticity of the pooled data, p-values under heteroscadasticity consistent are used. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

The results of Table 1 show that the coefficientson ASYM and MKSHAREare negative and statistically significant at the 0.01 level, thus supporting H1 and H6, respectively.The coefficients on TURN and SIZE are positive and statistically significant at the 0.01 level, thus supporting H3 and H5, respectively. However, the results in the same table show insignificance of the coefficients on DIV and PROFIT, thus not support H2 and H4, respectively.

Overall, the findings suggest that Thai firms' growth opportunities decrease with information asymmetry and gains in market share.The greater the firms' private information reflected by the bid-ask spreads, the higher the equilibrium required returns on the stock and the lower the firms' growth opportunities. When the firms as the market leader reach the maturity stage of product life cycle, they are less likely to make additional investment and thus inhibiting their business growth. The findings further indicate that Thai firms with high stock liquidity and large size enjoy more growth opportunities. Investors will require a lower rate of returns for a firm with high stock liquidity as they can anticipate the rate of returns on the stock. Moreover, larger firms vis-à-vis smaller firms are in the better position to explore new investment, therefore, growth opportunities are easily achieved by the large-sized firms.

IV. CONCLUSIONS AND LIMITATIONS

The objective of this research is to investigate the firm characteristics influencing growth opportunities of Thai listed firms. The empirical results show that the sampled firms' growth opportunities increase with stock turnover and firm size, and decrease with information asymmetry and market share. However, this research realizes the measurement error for growth opportunities. As the measure of future growth relies on the stock returns, the confounding effects likely exist despite controlling for the year fixed effects. Moreover, some factors, e.g. research and development expenditures, that possibly affect growth cannot examine due to unavailable data, leaving the rooms for future research to hand collect this data from firms' financial reports. Future research is suggested to focus on differences between industries to investigate the determinants of growth opportunities since it is possible that the conclusion is not hold.

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