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Meta Analysis: Impact of Debt - Equity Swap on Equity

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Abstract

Financial difficulties experienced by companies can be caused by management errors, intense competition, market changes, or sluggish economic conditions. This resulted in the company having to restructure its debt to avoid bankruptcy. One way that companies can do this is to carry out a debt-equity swap. We analyze the impact of debt-equity swaps on equity using a meta-analysis method that compares the results of previous studies. The conclusion from this research is that debt- equity swaps can have different impacts. In the short term, debt-equity swaps have a positive impact on equity by reducing the risk of bankruptcy and increasing the company's cash flow, but also have the potential to reduce equity if carried out when share prices are lower than normal prices. Carrying out massive debt-equity swaps tends to have a negative impact on equity.

Keywords: Debt Restructuring, Debt-Equity Swap, Equity

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INTRODUCTION

Companies experiencing financial difficulties are generally in a condition where revenues and profits are decreasing while the debt burden is increasing. The causes are management errors, intense competition, market changes, or sluggish economic conditions. This resulted in the company having to restructure its debt so that it could pay high debt costs and avoid the possibility of bankruptcy.

Debt restructuring can be resolved using many methods, including implementing a debt-equity swap scheme. This approach entails the conversion of debt into equity or business shares, resulting in debtors becoming shareholders in the company and their obligations being transformed into ownership stakes. Permana (2020) states that in the event of financial troubles, it is imperative to undertake debt restructuring in order to address the company's financial challenges. Businesses may incur losses as a result of external circumstances. These external influences encompass elements such as government policy, fluctuations in interest rates, strain on the native currency, and other related concerns. The company is facing circumstances that are outside of its control, resulting in a negative financial position. In order to address this, the company needs to be given the chance to reevaluate and manage its assets and liabilities. Debt restructuring plays a crucial role in this process, as it ensures the company's long-term survival by allowing creditors to modify the terms of the loan agreement.

The debt-equity swap (DES) policy is an option for companies experiencing financial distress because it can help reduce their debt burden and increase their capital simultaneously, and if carried out with good company performance, it can improve their financial performance so that companies can more easily fulfill their financial obligations. and regain financial stability. The primary utilization of equity issuance in developing economies is often for the purpose of recapitalizing existing businesses through debt restructuring or transferring ownership, rather than financing choices for financial development (Kim et al., 2019).

As stated by Blake and Pradhan (1991). A method for restructuring debt involves utilizing debt-equity swaps, which include the conversion of debt into firm equity. Study (Silaghi, 2017) related to the condition of a company that chooses to undertake a debt repurchase using a combination of debt and equity financing rather than a pure debt for debt exchange. Some companies will choose to issue equity to finance a portion of the debt repurchase proceeds, while others will choose not to use equity financing in the renegotiation.

Tlemsani (2022) proposes debt-equity portfolio swaps as a viable strategy for addressing governmental and private debt in the aftermath of the SARS-CoV-2 pandemic. As stated by Cepec and Grajzl in their 2020 study. Debt-equity conversion (DEC) enables creditors to acquire control over the operations of a firm facing financial challenges. DEC provides creditors with opportunity to generate profits via the business's recovery and the growth of their equity value.

DES is a strategy where a company exchanges debt into shares or equity. Companies may undertake DES because they hope that there will be an increase in their equity, which will ultimately help them to more easily obtain loans in the future. There are several studies on DES, but there are still few previous studies that analyze the effect of DES on equity. Therefore, it is imperative to carry out a comprehensive literature review on the impact of DES (Debt-Equity Swap) on corporate equity. It is hoped that the literature study will be able to collect the necessary data and information regarding the influence of DES. Analysis of the influence of DES on company equity will be carried out in this research.

This study aims to offer a comprehensive analysis for professionals and scholars in the financial industry to assess the influence of DES implementation on equality. The objective of this research is to furnish firms with valuable information to establish suitable financial structure policies and offer valuable insights to guarantee the long-term success of the company.

METHOD

This research uses a meta-analysis research methodology by comparing the results of previous studies related to debt equity to swap.

Benefits of Meta-analysis

- Increases Statistical Power: Meta-analysis can increase statistical power and provide more precise effect estimates because it combines data from multiple studies.
- Addressing Inconsistencies: Meta-analysis can help resolve inconsistencies between studies by evaluating and combining different results.

- Generalizability: Meta-analysis results are often more generalizable because they include data from a variety of different populations and conditions.

RESULTS AND DISCUSSION

According to (Nurpramana et al., 2022) Debt restructuring by means of a debt-equity swap or exchange of debt into equity has implications for low debt ratios and debt payment obligations, Consequently, this has a beneficial impact on the company's financial performance.

The debt ratio or also called the Debt Equity Ratio (DER) can influence a company's share price. If the DER ratio is too high, investors may be more wary of investing in the company because of the high risk of bankruptcy. Conversely, if the DER is low, investors may be more interested in investing because of the lower risk. So the debt - equity swap has an impact on the company's debt ratio (DER).

According to (Hidayat et al., 2021), when the debt ratio is low, the PER (Price Earning Ratio) is high. A high price-to-earnings ratio (PER) signifies that investors are ready to pay a higher share price for the firm compared to its earnings. Companies with significant growth prospects typically have a high Price Earning Ratio, indicating the market's anticipation of future profit growth. Conversely, corporations that experience minimal growth rates typically exhibit low Price Earning Ratios.

According to (Milman, 1996) debt - equity swaps in the short term can serve well as a means to facilitate the privatization process and allow a country to regain its credibility in the international business community. Using a debt - equity swap with the availability of cheap SOEs can provide investors with the opportunity for quick profits.

The debt - equity swap policy can also increase a company's liquidity because shares are easier to trade than debt. This is in line with research(Erić & Stošić, 2014), DES provides benefits to companies. DES can raise an increase in debt capacity, that is, open up the possibility for new loans, which leads to an increase in the company's liquidity and becomes the basis for further growth and development. The reduced amount of company debt means the risk of bankruptcy will decrease. This will give creditors and investors confidence that the company has managed risks well.

According to Wang (2017), a debt-equity exchange is the most effective method for commercial banks to address their high credit ratio in the short term. The primary implication is that if a debt-equity exchange is the exclusive method of resolving troublesome assets, it will result in financial risks, liquidity risks, cash payment risks, and moral concerns.

As stated by Wang (2017), the initial bank loan is projected to yield both the repayment of the principle amount and interest, as well as a consistent cash flow to provide a stable income. Bank loans have certain requirements about the timely recovery of cash and the potential to generate profits. Hence, if the debt-equity exchange is implemented over a prolonged period, the retrieval of bank money encounters heightened hazards.

As stated by Wang (2017), banks provide loans with varying time periods for repayment. The banks seek to receive the principal amount back in order to maintain their liquidity, and they charge interest to ensure profitability. Converting bank loans into equity will prolong the payback period and intensify the challenges faced by banks in managing their assets, liabilities, and liquidity. Furthermore, debt investment has a higher level of risk and uncertainty compared to equity investment. Inadequate corporate management might result in prolonged inability to repay bank money, leading to commercial banks being forced to retain company shares involuntarily.

According to Wang (2017), the introduction of debt-equity swaps exposes bank funds to risks, leading to a decrease in bank liquidity. This decrease in liquidity will have an impact on the daily cash payments of commercial banks. Large-scale implementation of debt-equity swaps will impose bankruptcy pressure on banks, ultimately resulting in systemic financial hazards.

Reducing the amount of company debt means the risk of bankruptcy will decrease. This will give creditors and investors confidence that the company has managed risks well.

According to (Wang, 2017) In the company's view, debt-equity swaps are the basis of the company's continued operations. Companies that face business risks only need to convert debt into equity thereby transferring some of the losses to the bank.

The study conducted by Kim et al. (2019) utilizes an extensive sample of subsequent offers carried out by publicly traded firms in Korea. Debt restructuring operations resulted in one-third of all equity issuances, and over a quarter of equity issuers experienced a loss of at least 50% of their paid-in capital. The inclination to release equity during severe financial difficulties is significantly more noticeable in enterprises managed by families than to firms not controlled by families. Issuing firms are inclined to use additional cash towards reducing their current debt rather to investing it in research and development. Additionally, over one-third of companies that issue equity see a change in controlling ownership within two years of the issuance.

CONCLUSION

Debt- equity swaps can have different impacts. In the short term, it tends to have the following positive impacts:

1. Reducing the risk of bankruptcy, in situations where the company faces a large debt burden, debt - equity swaps can help reduce the company's financial risk. Companies can reduce the risk of bankruptcy by reducing debt.
2. Affecting the company's ownership structure, debt - equity swap can affect the company's ownership structure because it can change the proportion of shares owned by debt holders to become shareholders. This can influence company decision making and voting rights at general shareholder meetings.
3. If the debt equity exchange is well executed and enhances investor confidence in the firm, it might potentially have a favorable effect on the company's share price. Debt equity swaps are conducted in response to the company's poor financial state, which can adversely affect share prices since the value of the shares being sold would decline.

4. Increase cash flow. A debt-equity swap carried out to reduce a company's debt will have a positive impact on equity because it will reduce interest expenses and increase the company's cash flow which has an impact on increasing the company's equity.

A debt-equity swap has the immediate impact of bolstering equity by mitigating the danger of insolvency and enhancing the company's cash flow. Debt - equity swap has the potential to reduce equity if carried out during bad financial conditions where share prices are lower than normal prices.

Implementing a debt-equity exchange over a significant period of time and at a big scale typically results in a decrease in equity due to the emergence of financial risk, liquidity risk, cash flow risk, and moral risk.

Research limitations:

1. This research only discusses the impact of debt-equity swaps on equity.
2. The method used only uses meta analysis.
3. This research does not include factors that are elements of equity related to debt-equity swaps.

Research suggestions:

1. The impact of a debt-equity swap is very dependent on the company's previous financial condition and ownership structure so it needs to be done carefully and in accordance with the company's needs.
2. Further research needs to be carried out by including factors that are elements of equity related to debt-equity swaps.

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