Applied Financial Economics Letters ›
Volume 4, 2008 - Issue 5

Original Articles

A threshold model for the Hong Kong warrant prices

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Pages 337-339 | Published online: 27 Sep 2008

Cite this article https://doi.org/10.1080/17446540701720600

Abstract

This article examines the factors that are not considered in the Black–Scholes model in determining the price of warrants. Using the outstanding percentage as a threshold variable, we test for the existence of threshold effect in warrant prices. It is shown that for warrants with a low outstanding percentage, an increase in the outstanding percentage will lower the call price. On the other hand, for warrants with high outstanding percentage, the call price is less affected by the outstanding percentage.

Previous article | View issue table of contents | Next article

Acknowlegement

We thank Ying Foon Chow for helpful comments. All errors are ours.

Notes

[1]A warrant is a listed option. Readers may refer to McGuinness (1999) for details of difference between stock options and derivative warrant.

[2]HKEx Securities and Derivatives Markets Quarterly Report.

[3]See, for example, Chan and Wei (2001), Chen and Wu (2001), Chow et al. (2003), Draper et al. (2001).

[4]According to Chapter 15A.52 of Listing Rules, issuer may issue additional options once outstanding quantity of the options is more than 50%.

[5]A Healthy Market for Informed Investors – A Report on derivative warrants market in Hong Kong, Securities and Futures Commission, November 2005.

[6]The outstanding percentage of a warrant is the percentage of that issue held by the general public, while the rest is held by the issuer.

[7]Sources of data: Warrant Supermarket, Hang Seng Bank (http://www.hangseng.com); Hong Kong Exchanges and Clearing Ltd. (http://www.hkex.com.hk/dwrc/download/dnfile.asp); Yahoo!Finance (http://hk.finance.yahoo.com).

[8]The sample date is 11 October 2006.

[9]In obtaining the Black-Scholes model price, volatility of the underlying stock is estimated from the daily volatility in past 90 days. A 5% risk-free rate is used.

[10]Using 20% or 30% outstanding percentage as thresholds provide similar a conclusion.

Table 1. F-test for threshold

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