



A study on the effect of rights issue announcement on companies listed in the national stock exchange

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Abstract

The study is undertaken to determine whether a rights issue announcement has an effect on the share prices of the companies listed at the National Stock. Rights issue is a way for companies to raise capital. Capital is raised when investors pay for the new shares that are being issued. Companies can use the raised capital to acquire or upgrade assets like equipments, buildings and industrial properties, make a take over, repay debts or save themselves from bankruptcies. Of course, a company can raise capital by other ways, such as borrowing from banks or issuing bonds. Rights issue will also cause significant changes to the company's cash flow. However, one must also understand that capital raised through rights issue can further strengthen the company's balance sheet and allow it to pursue strategic opportunities in core markets. Moreover, most the companies preferred rights issues to encourage the investor's in order to purchase their stocks which are available at cheaper price. The data has been taken from secondary sources for the past five years of right issue from 2013 to 2017.

Keywords: national stock exchange, right issue announcement, share price

Introduction

All companies need sufficient capital base to enable them in operating steadily. Companies use either equity or debt financing but equity financing is preferred as it forms a permanent source of funding that cannot be redeemed easily. The Listed companies all around the world typically raise external equity capital either from the existing shareholders under rights issues or from new investors through initial public offer. Rights issues provide a useful mechanism for raising equity capital for the companies and it also gives the existing shareholders the option of purchasing new shares which are normally issued at a discount to the prevailing market price in order to encourage the market participation. It is notable that the type and source of finance to be raised by the firm depends on a many factors prevailing inside and outside the market.

Objectives of the Study

- To evaluate the impact of right issue announcement on stock price
- To theoretically understand the underlying aspect of right issue
- To estimate the correlation between average abnormal return and nifty closing return
- To assess the investors reaction to right issue announcement

Scope of the Study

The local and foreign investors will be interested in the study in order to determine how to maximize their returns in the stock exchange over time. Corporate managers are provided with insight on how rights-issue offer and issue of additional debt affect the capital structure of a firm and its effects on the general market share price. This will help management to plan

and establish the amount of capital to be raised from rights issue which will enhance the value of the firm. The study is also significant to academicians in shedding light on whether rights issues has any effect on the value of a share. It will also be a resource to academicians who would carry out a similar research and those who want to gain an understanding in this area.

Research Design

The study was basically a quantitative approach and a descriptive research design which is aided by an event window. Data was collected from 2013-2017 with secondary data from 25 listed companies in the NSE. Data pertaining to stock prices, market index, and announcement dates was collected for 14 days before and after the issue of right announcement. Data was analysed through the use of the excel on the share prices and trading volumes over the event window to determine whether there was a significant effect of share price and trading volume on rights issue announcement.

Research Methodology

- One sample T-Test
- Correlation
- Descriptive Statistics
- Regression

Literature Review

According to Loderer & Zimmerman (2000) [8] the issuance of right issues in Switzerland found that substantial companies showed a positive result on its share price after the monthly announcement right issue. Similarly, the market portfolio returns during the period and around the rights issue announcements were increased and had abnormal returns are related with the companies' earnings prospects, changes in

financial leverage and stock market.

Tsangarakis Shah (2002) examines right issues by pointing that rights issue dominates in Asian market as well. He concludes his study by telling that among all equity financing, 60.96% occurrence and 76.96% by amount are prepared through rights issues announcement. The listed firms at the China exchange are similar to those of European and Asians nations as they all use right issues to be the only equity financing method to raise funds to satisfy their financial obligations.

Niranj. R (2012) conducted a study on the impacts of right issue announcements on share prices of companies listed at the Nairobi Stock Exchange. The study determined whether the average abnormal returns surrounding the rights issue announcement was statistically different from zero. The market model was used to derive the expected returns and a t-test statistic was used to test the hypothesis. The result was negative abnormal return, prior to the day of the rights issue announcement.

Sakwa Santal conducted (2004) a traditional event study approach in which the mean return over the estimation period was calculated. A t-test at 95% confidence level was done to test for statistical significance of the mean abnormal returns.

The results of the study show that stock returns react positively to rights issue announcements. A positive mean abnormal return was recorded over the event period with the highest abnormal returns being on day t+2. There was a statistical difference between mean abnormal returns observed during the event period and estimation period and no statistical significance for one event.

Bashir Abdula (2012) ^[2] investigated the market reaction to rights issue announcement on the performance of thirty one rights issues in Karachi Stock Exchange (KSE) from 2007-2011. They tested whether the investor can gain or lose an above normal return by relying on public information in a rights issue announcement. Using event study methodology, the study tested whether excessive abnormal return exists during event window. Abnormal returns were calculated by use of the market model and t-tests were conducted to test the significance. The study found evidence of existence of positive abnormal returns on event date. However this gain in shareholders wealth was statistically insignificant. The study concluded that the reaction of Karachi Stock Market is an indication of no rights issue announcement affects i.e. no wealth maximization for investors.

Data Analysis & Interpretation

Table 1: Descriptive Statistics Table

Abnormal Return		NIFTY closing return	
Mean	0.017713743	Mean	7404.456185
Standard Error	0.038644611	Standard Error	257.6532057
Median	0.00169376	Median	7089.425
Mode	#N/A	Mode	7089.425
Standard Deviation	0.193223055	Standard Deviation	1288.266028
Sample Variance	0.037335149	Sample Variance	1659629.36
Kurtosis	6.356526989	Kurtosis	-1.071471839
Skewness	0.846853174	Skewness	0.313148353
Range	1.117565	Range	4437.095714
Minimum	-0.53093	Minimum	5597.714286
Maximum	0.586635	Maximum	10034.81
Sum	0.442843585	Sum	185111.4046
Count	25	Count	25
Confidence Level (95.0%)	0.079758557	Confidence Level (95.0%)	531.7700806

Inference

From the above table it is understood that mean, standard error, median, standard deviation for average abnormal return are 0.017713743, 0.038644611, 0.00169376, 0.193223055

respectively. The mean, standard error, median, mode, standard deviation for NIFTY closing return are 7404.456185, 257.6532057, 7089.425, 7089.425, 1288.266028 respectively.

Table 2: Correlation Table

	AAR	NIFTY closing return
AAR	1	
NIFTY closing return	-0.116561614	1

Inference

Correlation was conducted to see if there is a relationship between nifty closing return and average abnormal return

before 14 days of the announcement on the right issue. From the results, It could be seen that selected nifty closing return and abnormal return are negatively correlated.

Table 3: One Sample T-Test Table

Days	AAR	t-TEST	Days	AAR	t-TEST
-14	481.6301	0.984	0	8031.709	1.625
-13	-286.19	-1.001	1	861.825	1.025
-12	-5795.24	-1.12	2	-120.613	-1.017
-11	2660.26	1.041	3	-1352.38	-1.002
-10	758.5327	0.999	4	-776.826	-1.009
-9	-139.092	-1.021	5	-1082.24	-0.564
-8	-68.2127	-1.024	6	-2445.75	-0.999
-7	1287.458	0.991	7	6648.295	0.998
-6	4535.139	1.001	8	1690.744	1.412
-5	768.535	0.782	9	2580.27	0.997
-4	452.5162	1.512	10	4371.1479	1.012
-3	925.4677	1.102	11	550.363	1.008
-2	-1327.3	-1.001	12	-3496.54	-1.241
-1	-2435.33	-0.99	13	-2087.14	-0.999

Inference

From the above table it can be understood that all the t-test values in the pre and post announcement period of right issue are less than 1.96 it means average abnormal returns are insignificant at 95 percent confidence level.

Results

- There is no significant impact of right issue on abnormal returns of the company.
- Correlation was conducted to see if there is a relationship between nifty closing return and abnormal return before 14 days of the announcement on the right issue. From the results, it could be seen that selected nifty closing return and abnormal return are negatively correlated.
- As all the t-test values are less than 1.96 it means abnormal returns are insignificant at 95 percent confidence level.

Research Gap

- The unexpected change in the in the price of share at the stock market at most of the times has been an issue of concern to market players.
- The companies issuing rights must release sufficient and relevant information to the market for proper interpretation of the issue.
- Predicting the behavior of share price in the stock market.

Conclusion

The predominant power of the company is rested in the hands of its existing shareholders. The main attribute of issue of right shares is that it makes conceivable equitable distribution of shares to the shareholders without disturbing the established equilibrium of shareholdings because right shares are offered to the shareholders depending upon their shareholdings in the company. The value of shares decline with the fresh issue but existing shareholders do not suffer on account of dilution in the value of their holdings. Therefore fall in the value of the shares will be reimbursed by getting new shares at a price lower price than the market price. They are prone to undergo if fresh shares are offered to the general public on account of the dilution in the value of their holdings.

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