International Journal of Innovative Research in Management Studies (IJIRMS)
ISSN (Online): 2455-7188
Volume 1 | Issue 1 | February 2016

YEAR WISE IMPACT OF RIGHTS ISSUE ANNOUNCEMENTS ON THE STOCK PRICES

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ABSTRACT

Rights issues takes place, when a company offers existing shareholders a right to purchase additional shares of the company at a given price, which is at a discount to the prevailing market price of the stock. There is need to study the significance of this emerging trend, its signaling effect on share price and its impact on the wealth of the shareholders. The study aims to check whether efficient market hypothesis holds for Indian stock market or not i.e., whether there is any movement in share prices before or after the rights issue announcements. The study includes Top 100 companies rated by Chartered Financial Analyst Survey 2008 and informational efficiency for last ten calendar periods- January. 2004 to December 2013 has been investigated. The results show that the Indian Capital Market is semi strong efficient as it is using the information relevant for security valuation and for investment decision making. The role of SEBI can be instrumental in preventing insider trading so that the confidence of the investors is maintained and the stock market can become more vibrant and dynamic.

Key words: Net Sales, Profit after Tax, Operating Profit, Market Capitalization, and Cumulative Abnormal Return

INTRODUCTION

The basic premise of carrying out rights offer is to raise additional capital. The company raises money from its existing shareholders, who have seemingly posed their faith in the company by virtue of being its shareholders, to invest in expanding capacities or to explore other investment opportunities. This, in turn, provides the company better leveraging opportunities. A higher equity capital base would assist the company to raise higher debt. This is because a company's debt-to-equity ratio would stand reduced, putting the company in a comfortable position to raise further debt from the market. A rights issue can offer a quick fix for a troubled balance-sheet, but that does not necessarily mean management will address the underlying problems that weakened the balance-sheet in the first place.

REGULATORY FRAMEWORK OF RIGHTS ISSUE IN INDIA

Section 62 of the Companies Act, 2013 provides: where at any time a company having a share capital proposes to increase its subscribed capital by issue of further shares then:

(a) Such shares shall be offered to the persons, who at the date of the offer, are holders of the equity shares of the company proportionately to their equity holdings on that date subject to the following conditions

(i) The offer shall be made by a notice specifying the number of shares offered and limiting a time not being less than 15 days and not exceeding 30 days from the date of the offer, with in which the offer, if not accepted, will be deemed to have been declined.

(ii) Unless the Articles of Association of the company otherwise specify, the offer shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favor of any other person; and the notice referred to in clause (i) shall contain a statement of this right.

(iii) After the expiry of the time specify in the notice referred to the above, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may proceed to dispose of such shares offered in such manner as they consider most beneficial to the company.

(b) To employees under a scheme of employees' stock option, subject to special resolution placed by a company and subject to such conditions as may be prescribed; or

(c) To any persons, if it is authorized by a special resolution, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered value subject to such conditions as may be prescribed.

REVIEW OF LITERATURE

By employing market model to investigate the rights issues on the NYSE between 1926 and 1966, **Scholes (1972)** documented excess returns prior to the issues and a little price drop in the month of issues, but no abnormal gains or losses thereafter.

He et al. (2003) evaluated the semi-strong form efficiency of Shenzhen Stock Market by examining the stock price reactions to releases of restructuring information, financial information and rights issues. Year-wise empirical results on restructuring information, financial information and rights issues could not provide support for the semi-strong form efficiency.

Marisetty and Veeraraghavan (2007) examined the securities price reaction to announcements of rights issues by listed Indian firms during the period 1997–2005.They had documented a positive but statistically insignificant price reaction to such announcements. The price reaction was significantly more negative for firms with a family group affiliation compared to firms with no family group affiliation. They had also found that a higher level of individual shareholding in the firm was associated with a more positive price reaction to the announcement.

Khan and Baker (2007) examined the short-term stock price reactions to announcements of equity rights offerings in Singapore between 1983 and 2003. They had investigated whether economic factors lead to different price reactions. The results showed that the cumulative abnormal returns (CARs) associated with rights issues differ significantly across economic conditions at the time of issuance. The CARs vary positively with Tobin's q-ratios, which indicate the availability of positive net present value investment opportunities of the firms issuing the rights.

Owen and Ann (2007) examined that the abnormal returns result from the announcement of a rights issue of equity in Australia and it was the first study outside the U.S. The determinants of the announcement effect were analyzed using a two-stage approach to control for the end ogeneity of the price discount. The discount was positively related to the offer size and negatively related to underwriter quality, supporting underwriter certification models. Finally they had found that announcements made by resource firms generate larger negative reactions than other issuers.

NEED FOR THE STUDY

There is need to study the significance of this emerging trend, its signaling effect on share price and its impact on the wealth of the shareholders. Further, it has been argued that if the capital markets are efficient then they would react immediately to various kinds of rights issue announcements. On the other hand, if the markets are inefficient then such information already gets trickled to the markets much before it is formally announced. This spreads rumors in the stock market which results in enhanced trading volumes in the shares of companies. This may also lead to insider trading by the management, the directors and the employees of the company. In such a scenario, the market may not react at all when the information is finally made public. This is a likely scenario in the case of emerging markets; as such markets are not believed to be as efficient as the developed markets and are, therefore, not expected to respond to new information about firms in the same way. The study aims to check whether efficient market hypothesis holds for Indian stock market or not i.e., whether there is any movement in share prices before or after the dividend announcements.

RESEARCH DESIGN

The study includes Top 100 companies rated by Chartered Financial Analyst Survey 2008 and informational efficiency for last ten calendar periods- January. 2004 to December 2013 has been investigated. The Analyst 500 companies have been ranked on the basis of their Net Sales alone. Besides, Net Sales, other parameters, such as like Profit after tax (PAT), Operating profit or Profit before depreciation and tax (PBDIT), Operating Profit Margin and Market Capitalization have also been considered.

For the present study, secondary data has been used. For exploring the objectives of this study, the information disclosure concerning the rights issue announcements have been collected from BSE (Bombay Stock Exchange) website. Data regarding share prices and Sensex has been taken from BSE (Bombay Stock Exchange) and NSE (National Stock Exchange) websites. The data on daily closing values of market proxy is obtained from Capitaline Database. Capitaline Database is maintained by Capital Market Publishers India Private Limited.

‘**Event Study**’ methodology has been used for the purpose of analyzing the corporate announcements effect. The event study methodology has been extensively used to assess the impact of an announcement of a particular strategy on the firm’s stock prices. This analytical approach is well accepted and has been widely used in various disciplines such as Finance, Accounting, Marketing, Strategy, E-Commerce and Law. **(Lane and Jacobson, 1995).**

The event study methodology has been used to estimate Cumulative Abnormal Returns (CAR) for a 15 day window period. Market Model Method (Single factor Model) has been used. The study endeavors to find the Cumulative Abnormal Return (CAR). Market Model assumes that all inter-relationships among the returns on individual’s assets arise from a common market factor

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that affects the return on all assets, i.e., the expected return on individual assets**.** The event study methodology has been extensively used to assess the impact of an announcement of a particular strategy of the firm's stock prices.

ANALYSIS AND INTERPRETATION

Rights issues takes place, when a company offers existing shareholders a right to purchase additional shares of the company at a given price, which is at a discount to the prevailing market price of the stock, to make the offer enticing for the shareholders and to ensure that the rights offer is fully subscribed to. Rights issue announcement dates for the period of January 2004 to December 2013 were collected using the three data source − Capitaline, BSE and NSE Websites. Rights issue announcements have been collected from www.bseindia.com. Data regarding share prices and Sensex has been taken from BSE and NSE websites. The data on daily closing values of market proxy has been obtained from Capitaline Database. This process revealed 21 observations that met the following criteria:

- The rights announcement date is to be reported in any of the leading financial dailies.
- Daily closing price data for the company over the period from 200 days before to 15 days after the announcement dates is available from the databases.

YEAR WISE SHARE PRICE RESPONSE TO RIGHT ISSUE ANNOUNCEMENTS

Table 1.1 gives data relating to the year wise movement of Average abnormal returns (AARs) and cumulative average abnormal returns (CAARs) of right issue announcements. A perusal of table 5.5 shows mostly negative average abnormal returns on the announcement day. Year 2012 saw highest announcement day return of 0.4262 which is statistically significant at 1 percent level. Year 2006 gave an announcement return of only -1.2691 percent which is lowest in the entire period.

Further, a comparison of Average abnormal returns (AARs) prior to the date of an announcement has been made. It has been noticed that the highest average abnormal returns (AARs) prior to the date of an announcement is 2.2781 in 2010 on day 4, whereas the highest average abnormal returns (AARs) after the date of an announcement is 7.0778 in 2010 on day 6. The lowest average abnormal returns (AARs) prior to the date of an announcement is -6.3160 in 2011 on day 4, whereas the lowest average abnormal returns (AARs) after the date of an announcement is -3.0860 in 2012 on day 12.

An analysis of movement in Cumulative Average abnormal returns (CAARs) over the years indicates significant variation. On the announcement day a Cumulative Average abnormal return (CAARs) of 3.5810 percent in 2010 was highest.

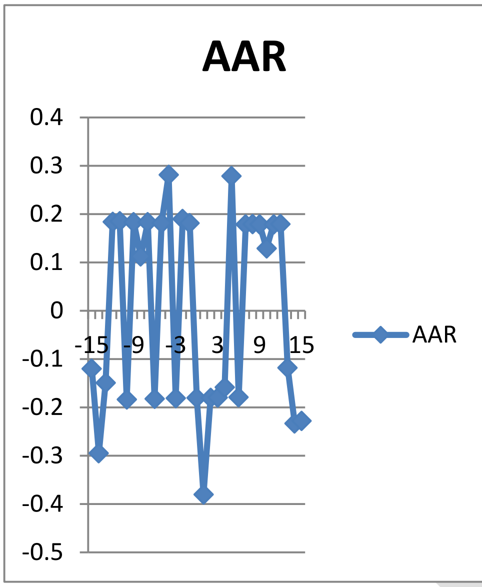
TABLE 1.1: Average Abnormal Returns (AARs) and Cumulative Average Abnormal Returns (CAARs) of Right Issue Announcements

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Days	AAR (%)	AAR (%)	AAR (%)	AAR (%)	AAR (%)	AAR (%)	AAR (%)	AAR (%)	AAR (%)	AAR (%)
-15	-0.1200	-0.3200	-0.0230	-0.6960	-0.8230	-0.0240	-2.3700	0.0924	-0.3450	-0.9920
-14	-0.2950	-0.4350	0.1005	-0.6110	-0.2510	0.0320	-0.3330	-0.2180	-0.5830	-0.8570
-13	-0.1490	-0.4440	-0.0480	-0.1550	-0.5240	-0.3560	-0.4700	0.0353	-0.6980	0.7010
-12	0.1842	-0.0920	-0.1650	-0.1960	-0.4840	-0.1530	0.0830	-0.1330	0.0730	-0.2340
-11	0.1854	-0.1820	0.4060	0.1850	-0.1450	-0.1250	-0.0840	-1.1760	0.1030	-1.3490
-10	-0.1834	-0.2690	0.4080	-0.1820	-0.4360	-0.1790	0.0800	-1.2840	0.0940	-0.3430
-9	0.1830	-0.2660	-0.7410	0.0990	-0.3930	-0.2370	1.0790	-0.3270	0.0390	0.3350
-8	0.1125	-0.2310	-0.7360	0.1240	-0.7070	0.2760	2.0790	-0.2990	0.0110	-2.3530
-7	0.1831	-0.2520	-0.5560	0.1200	-0.8910	-0.3150	0.7790	-0.3110	0.1330	-0.4160
-6	-0.1823	-0.4170	-0.7850	0.1490	-0.7220	-0.3610	0.0780	-3.2810	0.1340	-0.4660
-5	0.1816	-0.4570	-1.0200	0.0710	-0.6000	0.4030	0.0770	-0.2750	0.1070	0.5780
-4	0.2814	-0.5330	-1.2590	-0.0500	-0.8540	-0.4630	2.2780	-6.3160	-0.1100	-0.6580
-3	-0.1808	-0.6600	1.3010	-0.1400	-0.8160	-0.4610	0.0780	-0.3520	0.1880	-2.6350
-2	0.1901	-0.4720	1.1630	-0.2700	-0.8150	-0.3920	0.0760	-0.3870	0.2840	-0.5190
-1	0.1813	-0.3920	-1.1740	-0.0210	-0.9520	-0.3340	0.0750	-2.4170	0.3570	-0.4150
0	-0.1805	-0.3520	-1.2690	-0.1010	-0.8930	-0.3240	0.0760	-0.4160	0.4260	-0.3440
1	-0.3805	-0.2920	-1.2780	0.1470	-0.9770	-0.2990	4.0760	-0.4180	-0.2280	-0.3690
2	-0.1803	-0.3510	-1.4170	-0.1700	-1.0040	-0.3260	0.7500	-1.4110	-0.1290	-0.3470
3	-0.1798	-0.3340	-1.7680	0.1530	-0.9750	-0.3120	0.0750	-0.4350	-0.0690	-0.3240
4	-0.1587	-0.3170	-1.9200	0.1560	-1.0850	-0.2680	1.0750	-1.4450	-0.0360	-2.3090
5	0.2785	-0.3100	-1.6040	-0.1620	-0.9630	-0.2310	0.0750	-0.3980	-0.0790	-0.3130
6	-0.1789	-0.2950	-1.5320	-0.1640	-0.8080	-0.2110	7.0770	-0.3470	-2.0740	-0.3240
7	0.1790	-0.2780	-1.6180	0.1600	-0.6580	-0.1820	0.0790	-1.3740	-0.0540	-0.3332
8	0.1793	-0.2940	-1.5690	0.1560	-0.6250	-0.1980	3.0800	-0.3910	-0.0530	-0.3510
9	0.1790	-0.3110	-1.4970	0.1520	-0.6870	-0.1980	0.0800	-0.4000	-0.0590	-2.3240
10	0.1287	-0.3050	-1.5690	0.1440	-0.6660	-0.1850	0.0800	-0.4270	-0.0640	-0.3020
11	0.1787	-0.3010	-1.7800	0.1500	-0.6500	-0.1710	6.0800	-0.4180	-0.0710	-0.3190
12	0.1793	-0.3000	-1.9960	0.1550	-0.6330	-0.1690	0.0810	-0.4030	-3.0860	-0.3370
13	-0.1180	0.0567	-0.0690	0.0435	0.1214	-0.3020	-0.0080	-0.0150	0.0580	0.0235
14	-0.2330	-0.5220	-0.0710	0.1589	-0.3090	-0.1630	-0.0790	0.0831	-0.6320	0.0351
15	-0.2280	-0.2710	-0.0790	0.1539	-0.4250	-0.0230	-0.0110	0.0906	-1.0470	-0.0180

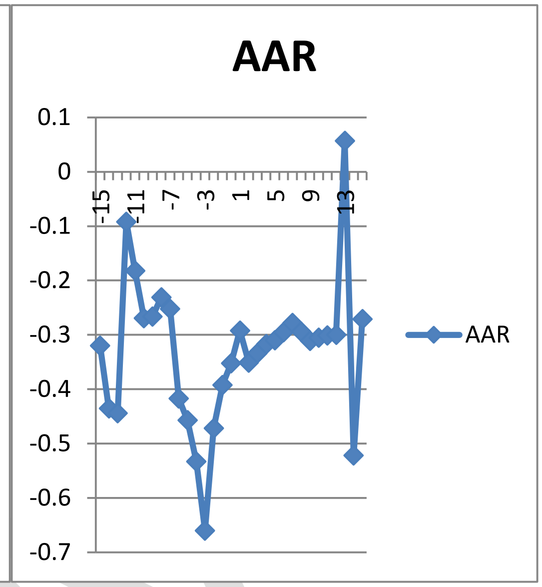
ISSN (Online): 2455-7188
Volume 1 | Issue 1 | February 2016

Figure 1.1: Year Wise Average Abnormal Returns of Right Issue Announcements

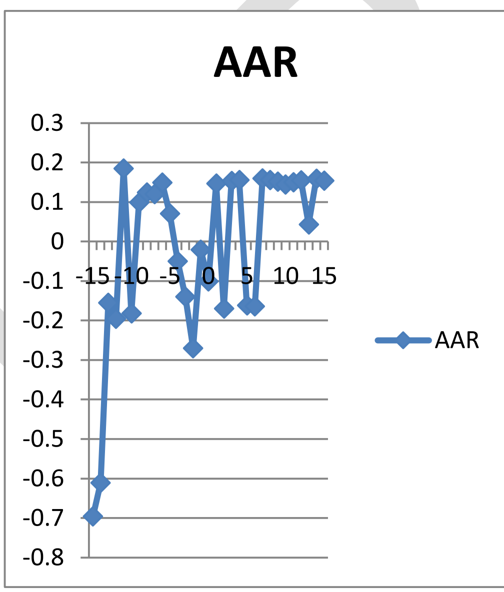
2004



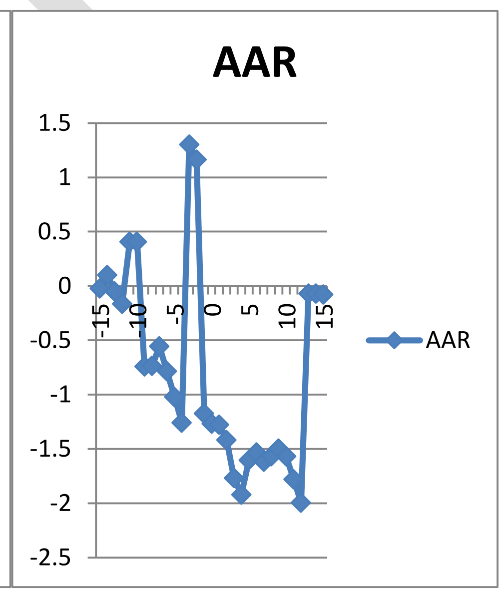
2005



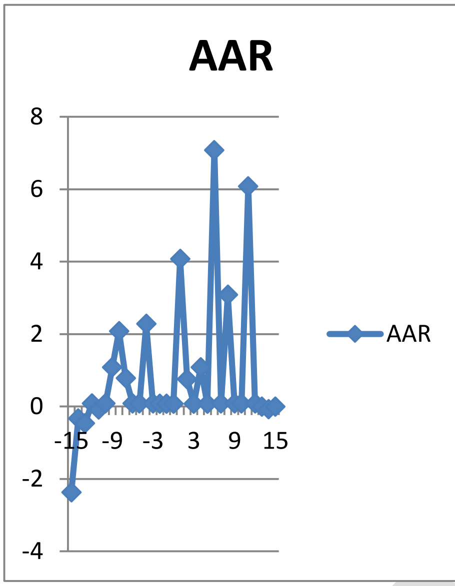
2006



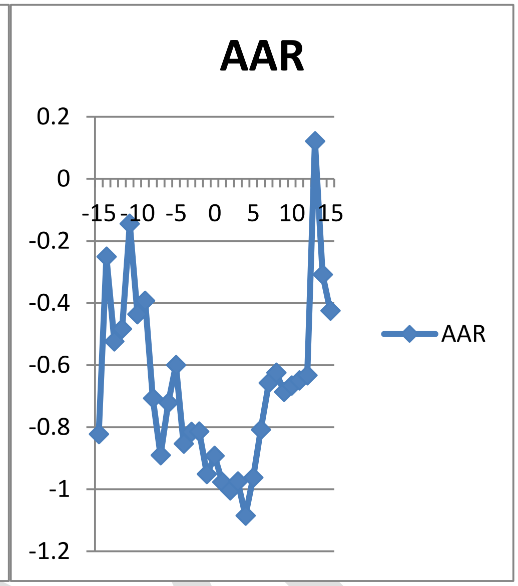
2007



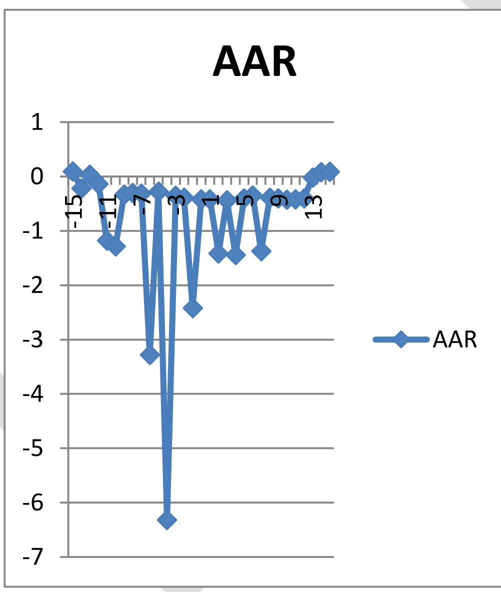
2008



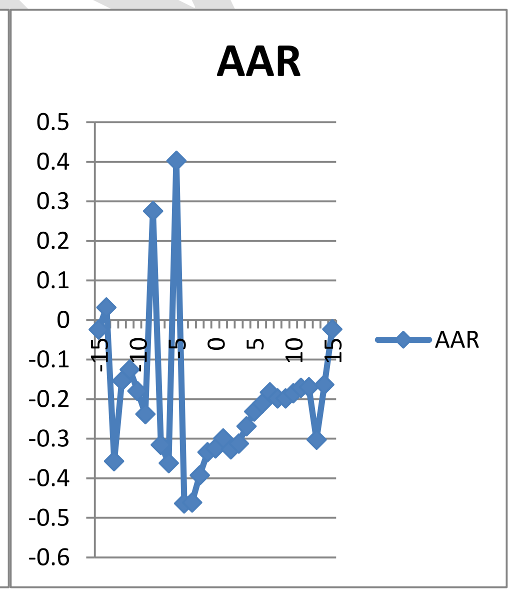
2009



2010



2011



International Journal of Innovative Research in Management Studies (IJIRMS)
ISSN (Online): 2455-7188
Volume 1 | Issue 1 | February 2016

2012 **2013**

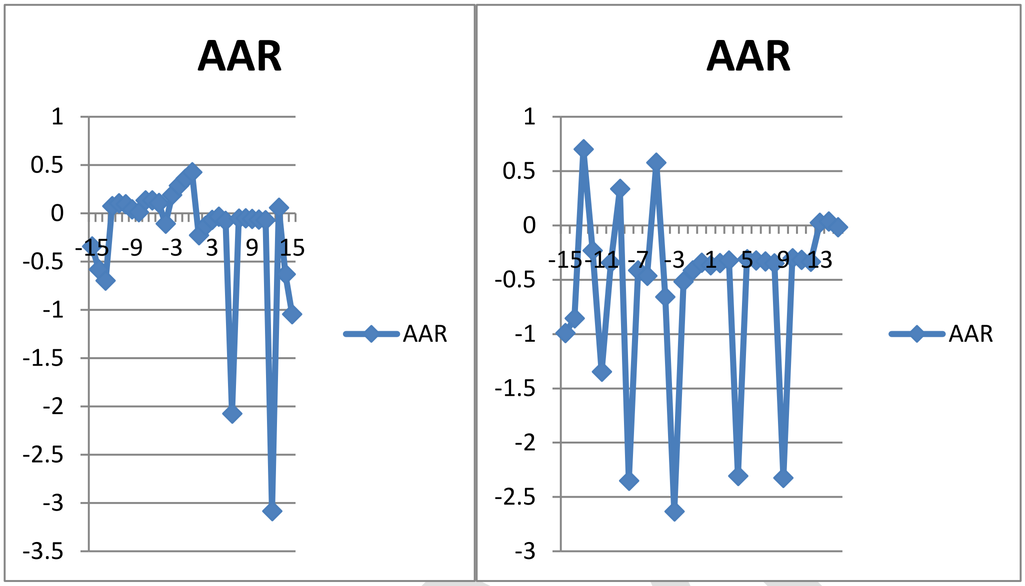


Figure 1.1 shows the graphical representation of year wise average abnormal returns of right issue announcements It has been seen that Average abnormal return (AARs) is fluctuating randomly prior to and post-announcement event period, thus, inference can be made that the abnormal returns are showing random trend due to right issue announcement. The figure indicates that for the 15 days before the announcement date, there is no consistent pattern of abnormal returns of companies engaging in quarterly earnings announcement. It depicts that the maximum average abnormal return (AARs) is 7.0778 percent in 2010.

RECOMMENDATIONS AND SUGGESTIONS

From the foregoing analysis, the following suggestions have been made to make Indian capital market more efficient. It is a known fact that reliability of accounting information is important. The regulation of accounting norms and audit practices will improve the reliability of accounting information. The larger the number of analysts, the more efficient will be the market. Thus, market efficiency depends upon the number of investors in the market, particularly the institutional investors and number of analysts. There is need to promote programmes that will produce professional analysts. The more visible a company, the more perfect its market is likely to be 'Perfect' implies that most of the likely factors affecting the price of its securities are presumably known to the market and vice versa. The existence of insider trading or information leakage can erode the confidence of investors in the instrument and may be viewed by them more as a tool to deceive than to benefit them. SEBI should mull over the listing rules, and suitable amendments are the need of the hour to prevent such practices.

LIMITATIONS OF THE STUDY

The results of the study could have further improved, provided the study had covered even larger sample and longer time period. The study has conducted the analysis on the daily stock returns. It is quite possible that the results could have been different had the analysis been done on monthly or annual returns data. The closing share prices have been taken from CAPITALINE database. The results may differ if it would be collected from any other database. The non-availability of trading data reduced the sample size for present study. The result would have been more comprehensive, had the trading data relating to all announcements been available.

CONCLUSION

The stock market efficiency is one of the most important areas in finance that is often researched. As no stock market can be efficient in the absolute sense, researchers have categorized the stock market efficiency into weak, semi-strong and strong forms. There is strong evidence in favor of Indian stock market being efficient in the weak form. The limited number of studies on the strong form makes it difficult to conclude either in favour or against the strong form. Numerous studies have examined the semi-strong form of Efficient Market Hypothesis and come to conflicting conclusions. In the light of this fact, this study investigates the semi-strong form of Efficient Market Hypothesis. The results show that investors perceive the right issue by the negatively, as the firm is distributing the shares to the existing shareholders as against floating a new issue in the market. As signaling theory postulates, firm's actions convey some meaningful information to the investors. The values of Average Abnormal Returns and Cumulative Average Abnormal Returns of all the samples are equally significant at 95% degree of freedom which means that the share price reflects the Rights Issue announcements.

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