

Shareholder's Wealth Effect of Rights Issues of High Ownership Concentrated Firms

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Abstract: This study evaluates shareholder's wealth effect of rights issue of high ownership concentrated firms. Rights issue were considered, based on volume and premium, and shareholder's wealth measured with market valuation ratio. Population consists of 67 quoted companies on the Nigerian Stock Exchange (NSE) as at 31st December, 2015, that conducted rights offering between 2004 and 2015. 65 companies were sampled. Regression was used as a tool of analysis, and estimated results, tested with *t* statistics and *f* test. Findings show that both rights issue volume and premium interacted with ownership concentration have negative and significant effect on shareholder's wealth. It concludes that rights issue of high ownership concentrated firms do not drive shareholder's wealth, and thus recommends that regulators should introduce credit rating of companies quoted on NSE, to reveal the true performance of large ownership concentrated companies which may help to change the perception of secondary market investors about the companies.

Key Words: Shareholder's wealth, Rights issues, High ownership concentration.

1. INTRODUCTION:

The drive of all theories of capital structure is to recognize whether the capital structure has any impact on firm's performance or not. This is based on the premise that organization exist to maximize profit (in the short run) and wealth (in the long run). Therefore, any decision taken by organisation drivers or agents is expected to enhance shareholder's wealth and also the stakes of other financial claimants (Ogbe, Ogbe & Alewi, 2013). Wealth creation and maximization sometimes may require more capital than firms are able to generate and there is no unified theory available to explain corporate financing. Already publicly traded companies either go for equity or debt to help overcome their funding shortfall, and to the extent they issue equity, face choice of issuing it to existing shareholders or making public issue. The first one is described as rights issue.

In rights issue, certain rights are given on a pro rata basis to current shareholders. These rights are short term warrants and purpose of the rights are to preserve the control position of existing stockholders and to protect them against dilution of ownership (Arif, Khan & Baker, 2007). So ownership structure will remain unchanged if all current shareholder's subscribe to their allocation or become more dispersed through public offer or convertible (including warrants and employee stock options) with an increase in the number of shareholder's either individual or institutional. Koonigi, (2007), argued that dilution of ownership could be dangerous especially if share of ownership directly affects the control rights of the investors. Consistent with this, Colye (2002) pointed out that companies with diverse ownership are controlled by managers even if the formal control belongs to the shareholders. Thus, ownership would seem to fail in monitoring the managers and would end up with big principal-agent problem, whereby managers would tend to prioritise their own interest rather than the value of the firm. So, if corporate decision makers or managers maximize the existing shareholder's wealth, rights issues would not give rise to any conflicts of interest because there will be no new shareholders involved (Wu & Wang, 2009). The choice of rights issue can therefore be related to ownership structure as well as the behaviour of large shareholders. In the view of Hansen & Pinkerton (1982) firms with concentrated shareholders will choose rights issue. The essence is to preserve private benefit of control (Wu, Wang & Yao, 2014).

The impact of large ownership on firm performance which could translate to wealth maximisation, seems to have positive and negative effects. The positive effect is hinged on the fact that size of ownership stake and the incentive to monitor, is positively correlated. This is possible owing to the ability of the ownership to get approval in the decision making bodies since it is easy for them to get majority votes in such bodies, which could generate improved corporate performance and equally benefit the minority. Moreso, a higher level of ownership concentration or more block holders could suggest stronger monitoring power of investors over a firm's managerial decisions because of the incentives from these owners to proactively safeguard their investment. Usman & Yero (2012) opined that few individuals with more stake have more reason to be worried about their investments and hence monitor the management of the firm's affairs. The underlying argument is that owners with significant amount of shares may take aggressive actions, either directly or indirectly over firm decisions, such as the election of board members and replacement of CEO with their voting powers and thus thwart managerial control of the board. As such, ownership concentration can be an internal governance

mechanism that helps reduce the likelihood of managerial opportunism because managers and boards of directors are more likely to take into account the preference and interests of large shareholders. Consistent with this, Hu & Izumida (2008) argued that ownership concentration has the potential to limit the agency problem and then generate improved corporate governance performance.

Comparatively, an ownership structure dominated by small uninformed investors, are not disposed to efficiently negotiate managerial incentive contracts that align owners and manager's interests and can be manipulated by the management (Ezugwu & Alex, 2014), because no shareholding could be sufficiently powerful to be able to exert any real influence with management. This impresses that firms with a low level of ownership concentration (diffused ownership), might indicate weaker governance power, because investors with less ownership interest have little incentive to pay attention to the strategic discussions of the firms and thus are less, motivated to closely monitor and discipline top executive behaviours (Grossman & Hart, 1996). Thus Shleifer & Vishney (1986) regard the existence of large shareholder's to be good for the value of a firm. Supporting this assertion, Balachandran, Faff & Theobald (2008) and Gajewki & Ginglinger (2002) reported positive correlation between abnormal return and concentrated ownership. Saifullahi, Mohammed & Hassan (2015) show that ownership concentration has positive strong and significant impact on the performance of listed conglomerate firm in Nigeria. Cronqvist & Nilsson, (2005), reported that the popularity of right issue in European countries is connected to family control of public companies.

However, ownership concentration can be seen in a bad light. It's argued that large shareholder control could constitute an expropriation threat which would reduce managerial initiative and contractible investment. Setia-Atmaja, (2009) viewed the controlling shareholders to have greater incentive and the ability to expropriate some of the firm's wealth at the expense of minority shareholders, Lemmon & Linus (2003), opined that ownership concentration could cause side-lining of the minority shareholders, while Holmstrom & Tirole (1993) believe that concentrated ownership reduces monitoring of the firm by the stock market participants, thereby reducing the amount of public information available about the firm. If these arguments stand, concentrated ownership firms cannot be said to be performing well, and additional capital through rights will certainly not impact on the firm's market valuation.

A host of studies that have examined wealth effect of rights offerings, recorded significant decline. In 2004, Pastor-Lyorca & Martin-Ugedo investigated long-run effect of shareholder's wealth and firm's operating performance following SEO with rights. The result shows that 44 rights issues substantially underperformed the different benchmarks employed. In Brazil, Medeiros & Matsimoto (2005) examined stock price performance linked to the announcement of equity issues, results show a negative abnormal return. Kabir & Roosenboom (2003) examined stock market announcement effect of rights issues in Netherlands. They observed a statistically significant stock price decline. A further stock price decline was also observed during subscription period. Karanja (2006) found out that most firms that announce rights issue, experienced a decrease in share price after issue at least in the very short run. Syokau (2014) examined the impact of a rights issue on the earnings per share of listed company in Kenya. The result shows drop in profitability with statistical decline in earnings per share (EPS) and the market price share (MPS) after the right equity issue. Otieno and Ochieng (2015) Investigated the effects of right issue announcements on stock returns for firms listed on the Nairobi Securities Exchange, the study established that rights issue announcement results into a negative abnormal stock return for the listed firms. In Nigeria, the stock prices of many companies that conducted rights issues in the past are on the down trend now. Nwanna (2008) document that all banking sector stock fell below their values, after the so many offers that took place between 2005 and 2008.

This study is anchored on signalling theory, which believes that there exists an information asymmetry about the quality of issuing firms between the different parties involved (Chen, 2005). Heinkel and Schwarts (1986) developed a signaling model, and argue that there is information content in the choice of financing method made by the firm and the choice reveals either partially or totally the quality of the firm. Thus The theory suggests that high quality firms tend to retain their proportions of shares. Leland & Pyle (1977) agree that the retention of shares by insiders, signals better future prospects for the firm. Supporting this argument, Ahsan & Alam (2014) reported that, if right shares are accepted by shareholders warmly, it could be an indication that financial position of the firm is statistically good. The objective of this study is to evaluate shareholder's wealth effect of rights issues of high ownership concentrated firms, with the view to determining whether large shareholder's influence market values.

1.1 The hypotheses are:

- H_{01} Rights issues size of high ownership concentrated firms, do not significantly affect shareholder's wealth.
- H_{02} Rights issues premium of high ownership concentrated firms, do not significantly affect shareholder's wealth.

2. LITERATURE REVIEW:

In financial management, wealth is defined as value of the shareholder's equity. The single objective of a firm existence is to maximize profits in the short run and maximize shareholder's wealth in the long run (Fredman, 1970; Jensen 2001) as reflected in the market value of the firm's shares. Value maximization stressed that managers

should make all decisions so as to increase the total long-run market value of the firm which is the sum of the values of all financial claims on the firm-including equity, preferred stock and warrants. (Jenson, 2001). Accordingly, firms engage in right issue as a means of generating more capital to finance their expansion plans and internal operations (Ramirezi, 2011), and concentrated corporate ownership is expected to enforce optimal utilisation of the resources to improved performance and be able to maximize wealth.

Previous studies documented several explanations for market reactions around rights issues. Information asymmetry is one of the most cited explanation. Ross (1997), Myer & Majhuf (1984) and Miller & Rock (1985) introduced information asymmetry models that predicts market prices response to changes in the capital structure of the firm. The models predicted that the announcement of a new SEO releases negative information about the firm and will create all things being equal, a drop in the market value of the firm. Consistent with this, Roosenboon, and Kabir (2003) Investigated the stock market announcement effect of rights issues and post-rights issue operating performance of firms in Netherland between 1984-1990. The result shows a statistically significant stock price decline on announcement of rights issues. They also found statistical support for asymmetric information as a factor that explained the decline in abnormal stock and operating performance. Hammer & Perman (2015), analyzed rights offerings on the Swedish stock exchange during the year 2006-2013. The main purpose of the research is to examine the announcement effect and long term effect of firms conducting seasoned equity offering and also to find out whether information asymmetry is the main explanation for the abnormal returns around the announcement day of SEO. Results show that firms announcing SEOs do experience negative abnormal returns and also perform poorer than the market in the post event period. Information asymmetry was also found to be potent explanation of the abnormal returns. the result is similar to the findings of Salamudin (2001).

To reduce the severity of information asymmetry, Walker and Yost (2008) argued that providing specific information related to the SEOs could increase value of the firm at the announcement day. In that line, Deepak and Vijaylaxmi (2010) document that general trend of regulatory changes towards liberalizing the use of rights issues in increasing the disclosure aspects of rights improved rights issues activities. They found out that disclosures related to shareholding pattern, debt-equity ratio, and financial performance of the company and use of funds raised through rights issues, increased number of companies making rights issues, amount of rights as well as percentage of rights issues to total equity capital, during span of 17 years of post-reform period compared to 22 years of pre reform period. Similarly, Ogada (2014) investigated, the impact of right issues on share returns of listed firms in Nairobi security exchange between 2005 and 2012. The study adopted an event study methodology which attempted to establish the information content of rights issue on share returns. Findings show that market returns were significant after right issue than before rights issue, but the information content do not affect stock return which maybe an indicator of market efficiency. Holderness (2016) provided that shareholder's lower participation is another reason for negative stock reactions. He examined shareholder's non participation in valuable rights offerings and found out that offerings with lower shareholder's participation, fall short in raising publicly stated capital goals. His finding also reveal that rights are far more common in countries with institutional practices that limit non participating shareholder's wealth losses.

Another reason provided by Kim & Purnanamdham (2013) is weak governance. They found investors worried about non-productive use of SEO proceeds when changes in the law weaken external pressure for good governance. The monitoring hypothesis, suggests that a large shareholder have greater ability and incentives to monitor and discipline the firm's managers, thereby creating corporate governance. Supporting this argument, Eswaran Velayuthan (2015) examined price reaction to announcement of rights and bonus issues by firms listed on Columbo Stock Exchange (CSE) during the period 2008 – 2013. They document that market reacts negatively to the announcements of rights offerings. Cross sectional analysis conducted shows that market reacts more unfavourably to rights issues with lower issue size, higher risk, lower reassurance stock run-up, lesser concentrated ownership lower profitability and smaller firms. Tsangarakis, (1996) investigated shareholder wealth effects of equity issues in emerging markets in the period 1981-1990. He explored 59 rights offerings in Greece and reported that abnormal returns are associated negatively with share ownership diffusion. Conversely, Ginglinger and Gajewski (2002), examined seasoned equity offerings in France. A standard event study was performed to measure the average impact on French stock price of seasoned equity offering announcement. They found that share price effect is positively related to block holder's take-up announcement for firm with prior concentrated ownership. Likewise, Wruck (1989) document that announcement of private sale of equity, increases shareholder's wealth by an average of 45%. The increase was attributed to ownership concentration.

3. METHODOLOGY:

The researcher adopted ex-post facto research design. 65 out of 67 companies that conducted right issues between 2004 and 2015, and are quoted on the NSE, were sampled based on complete data and the number of right issues made within the study period is 96 (ie 96 exposures). The sampled companies were categorized into two, large ownership concentration and dispersed ownership companies Ownership concentration, measures existence of large shareholder's in a firm. Large shareholder is seen as an investor that has significant influence on an entity. According to IFRS 27, significant influence is the power to participate in the financial and operating policy decisions of an investee

and it is presumed to exist if the investor holds 20% or more of the equity shares of the investee. Berle and Means 1932, argued that shareholdings were sufficiently large to have working control through voting power, if it was larger than 20%. So companies having 20% and above are classified as large ownership concentrated, while companies having less than 20% of the total shareholdings are classified as dispersed. Data were collected from the NSE annual report, the companies' annual reports from 2004 - 2015 and hard copies of daily closing share prices available in the NSE. A cross sectional multiple regression methodology was employed for the analysis of the variables in the specified models. t-statistics and f-test used to test Individual and overall statistical significance of the variables respectively. The goodness of fit of the model was tested using the coefficient of determination (R-squared). The nature of selected companies used in this study was determined with descriptive statistics.

Model overview.

Multiple regression models with an error term (α_1) and after adjusting for firm size effect, is specified in econometric form as

$$\text{Market valuation} = \alpha_0 + \alpha_1 \text{SizeR}_t + \alpha_2 \text{Rip} (P_R - P_m)_t + \alpha_3 \text{ROCD}_t + \alpha_4 \text{FSIZE} + \epsilon_t$$

Where:

Market valuation = measured as company stock prices divided by earnings per share

SizeR = Right issue volume

Rip = Right issue Premium/Discount ($P_R - P_m$).

ROCD = Rights Ownership concentration dummy, where “1” is assigned to company with large ownership concentration and “0” is assigned to company with dispersed ownership.

Fsize= firm size is used as a control variable. This is measured as the log of total assets of the sampled companies.

α_1 = error terms over the cross section and time.

To evaluate the effect of ownership concentration on the work, ownership concentration dummy was interacted with right issue size and right issue premium. This would mean that the models will be operationalized differently thus:

$$\text{Market Valuation}_i = \alpha_0 + \alpha_1 \text{ROCD}_i * \text{SizeR}_i + \alpha_2 \text{ROCD}_i * \text{RIP} + \alpha_3 \text{FSIZE} + \epsilon_i$$

With $\text{ROCD} * \text{SizeR}$, and $\text{ROCD}_i * \text{RIP}$ being the coefficient of interaction between ownership concentration and right issue size and right issue premium respectively. The presumptive signs of the parameters in the specifications are: $\alpha_1, \alpha_2, \alpha_3 > 0$

4. RESULTS AND DISCUSSIONS:

Table 1: Descriptive statistics of the study variables from 2004 to 2015

Variables	Mean	Std.Dev	Jarque-Bera
MKTVAL	0.81	7.23	13374.41 (0.00)**
RSIZE	2.31	0.00	2768.66(0.00)**
RIP	0.97	0.78	479.82(0.00)**
ROCD	0.40	0.49	13.56(0.00)**
FSIZE	7.16	0.77	2.44(0.29)
All data observation	96	96	96

Source: author's computation 2018

Table 1. shows the mean (average) for each of the variable, their standard deviation (degree of dispersion) and Jarque-Bera (JB) statistics (normality test). Results in the table provide some insight into the nature of the selected companies that were used in this study. Market valuation variable (MKTVAL) has an average value of 0.81, which shows a reasonable performance on the average among the sampled companies within the period of study. Hence, most of the companies were favorably valued in the market within their right issue period. The JB statistics also shows that the variable is normally distributed. Right issue size shows an average value of 2.31 with standard deviation of 0. This suggests that there was no much variation in the volumes of issues of the companies over time. While some companies made smaller issues, others made significantly higher issues making them to average closely in the long run. The variable is also normally distributed as shown by the JB statistics. The right issue premium showed that the average premium stood at 0.97%, showing that a significant portion of the companies sampled issued their shares at premium. Ownership concentration dummy(ROCD) shows an average concentration of 40% with a moderate variation as shown by the Standard deviation. The variable is also normally distributed within the sample period. Lastly, the firm size variable is not normally distributed, as some of the sampled companies were significantly larger than some in the sample. But this wouldn't affect our result.

Correlation Analysis

In examining the association among the variables, the study employed the Pearson correlation coefficient analysis and results are presented in the table below.

Table 2 Correlation Analysis

	MRKVAL	RSIZE	RIP	ROCD	FSIZE
MRKVAL	1.00	0.09	0.10	-0.05	0.04
RSIZE		1.00	0.00	-0.15	0.02
RIP			1.00	-0.11	0.12
ROCD				1.00	0.13
FSIZE					1.00

Source: author's computation 2018

Table 2 shows that market valuation (**MKTVAL**) is positively correlated with right issue size, right issue premium and Firm size while negatively correlated with ownership concentration. Hence, increase in Right Issue size, Right Issue premium and Firm Size drives market valuation of the companies up wards while high ownership concentration has the tendency to reduce the valuation of sampled companies in the market. The results also revealed that no two explanatory variables are perfectly correlated, so there is no problem of multi-collinearity.

Regression results

Table 3. Effect of rights issue of high ownership concentration on shareholder's wealth.

VARIABLES	coefficients
C	-2.36 (-0.83) [0.40]
ROCD*SizeR	-0.00 (-0.53) [0.05]
ROCD*RIP	-0.18 (-0.38) [0.00]
FSIZE	0.45 (0.88) [0.37]

R-Squared	0.30
Adj-R-Squared	0.29
F-Statistic	10.12(0.05)
(n)	96

Note: Parentheses () are t-statistic while bracket [] are p-values

From table 3 above, ownership concentration dummy interacted with right issue size (**RIGHTISSUESIZE*ROCD**) is negatively and significantly related to Market Valuation ratio of sampled companies at 5% level as revealed by the P_value of [0.05]. This means that, sampled companies with high ownership concentration will experience some significant decrease in their market ratio during issuing period. This result is the same with right issue premium(RIP) which happens to be more significant at 1% level of significance as shown by the p_value of 0.00. The result suggest that shares of large ownership concentrated firms are not well accepted by the market and right issuance might send a bad signal to the market as investors might see that as possible sign of hidden problems in companies with large ownership concentration. We therefore reject the hypotheses one and two as stated and conclude that right issue of high ownership concentrated firms significantly and negatively affect market valuation ratio of issuing companies within the period under review. The finding does not support the work of Eswaran Velayuthan (2015), which document that market reacts more unfavourably to rights issues with lesser concentrated ownership. The control variable in the model (**FSIZE**) is positive and non-significant in driving market value. This is an indication that bigger companies are valued favourably by market participants, but in this case, such positive valuation is not significant given our period of study.

The results presented in table 3 also show that the R-squared and adjusted R-squared values were (30%) and (29%) respectively. This indicates that all the independent variables jointly explain about 30% and 29% of the systematic variations in the model for the sampled period (2004-2015). This goes ahead to reveal that more variables need to be

captured in the model to improve its predictive power. The F-statistics (10.12) with a p-value of 0.00 shows that the model is generally significant at 1% level which means that the model was well specified and the relationship linear.

5. CONCLUSION:

The study concludes that large ownership concentration does not drive shareholder's wealth. Therefore, it is recommended that regulators should introduce credit rating of companies quoted on NSE, to reveal the true performance of large ownership concentrated companies, which may help to change the perception of secondary market investors about the companies.

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