CORPORATE FINANCING THROUGH RIGHTS ISSUES

BY

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A Research Project Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Masters of Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY

FALL 2014
DECLARATION

I, the undersigned declare that this is my original work and has not been submitted to any other college or institution other than the United Stated International University in Nairobi for academic credit.

Signed ……………………………………… Date: ………………………………………

Lydia Wachira (ID No.622990)

The project has been presented for examination with my approval as the appointed supervisor.

Signed…………………………………… Date……………………………………

Dr. Amos Njuguna

Signed…………………………………… Date……………………………………

Dean, Chandaria School of Business
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ABSTRACT

A rights issue is one of the ways through which organisations raise funds to finance their investment plans. The purpose of this study was to investigate the use of rights issues in raising capital. The study was guided by four research objectives namely: to determine the factors that lead organisations to choose rights issues; to determine the factors that influence the success of rights issues; to determine the challenges encountered during rights issues and the measures that can be taken to enhance the use of rights issues.

The study employed a descriptive approach using primary data. The population for this study consisted of all the rights issues made in the Kenyan capital market. From this population a sample was selected, that comprised rights issues made during the period 2004 to 2012.

A questionnaire was designed and used to collect primary data for the sample, targeting a total of 30 respondents. The respondents were key informants in the companies that made rights issues during the period of study, as well as financial consultants involved in rights issue transactions. Data collected was analysed using quantitative analysis techniques. It was entered into a statistical software (Statistical Package for Social Sciences (SPSS)) and analysed using frequency distribution, mean, standard deviation and coefficient of variation. A total of 18 rights issues were made during the period studied. With the exception of two issues; all the other issues were oversubscribed.

The study identified the drivers to the use of rights issues as: the presence of a favourable regulatory environment; a high level of certainty and the need to take advantage of temporarily high stock prices. Low floatation costs and the need to preserve ownership and control were not rated as very significant in the decision to use rights issues.

The factors that influence the success of rights issues were identified as: high shareholder take up the performance of the issuing firm; the purpose for which funds were raised and the trend of the stock market at the time of the issue.

The challenges to financing through rights issues are: determining an appropriate timing; limited investor base; high future dividend payment; the high cost of contacting each shareholder and the negative effect on stock prices.
The measures to address the challenges to rights issues were identified as: selection of an optimal subscription price; analysing the shareholder structure and the presence of underwriting.

The study found that there had been a rise in the use of rights issues in the Kenyan market, and suggests that more organisations should use rights issues to raise funds. To achieve this, the study recommends that the Capital Markets Authority should encourage and facilitate the use of rights issues by creating a regulatory framework that is not complex for organisations to comply with. The study also recommends that future studies should investigate the long run effects of rights issues on stock prices and firm performance in order to determine whether there are any negative long run effects that organisations should be aware and therefore put preventive measures in place after making rights issues.
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Problem

Every firm needs adequate capital to perform efficiently. Generally, firms fulfill their financial requirement by issuing equity share, preference share, debentures and long term bonds. Rights issue is one of the instruments to raise additional capital (Pathak and Giri, 2008). According to Breuer (2006), there are two ways to raise new equity capital; namely free offering and rights offering. In contrast to free equity offerings, rights offerings are characterised by the creation of tradable subscription rights for incumbent shareholders that without a sufficient number of subscription rights, the purchase of new equity shares on the primary capital market is not possible. The rights issue gives both the shareholder and other investors an opportunity to participate in raising the capital of a company. However if the issue is successful and the take up by existing shareholders is 100%, non shareholders do no get to participate in the issue (Holderness and Pontiff, 2012).

A rights issue usually is made before a new issue to the public because existing shareholders have the “right of first refusal” on the new shares (preemption right). In the UK, this right is laid out in the Company’s Act 1985 as well as the London Stock Exchange’s Listing Rules. Even when shareholders’ pre-emptive rights have been excluded through shareholder approval, European issuers have relied on rights offerings to raise new capital because they enable existing shareholders to avoid dilution of their percentage ownership interests in the issuer. As a result, rights offerings by European companies have not had the stigma of being a capital raising method of last resort (Chilstrom, Goldschmidt and Chaudry, 2009).

By exercising their preemption rights, existing shareholders are able to maintain their percentage holding in the firm. However, Holderness et al. (2012) found that shareholders in some countries sometimes waive their pre-emptive rights and their firms issue equity to outsiders through public offerings or private placements. The rights issued to a shareholder have a value, which is determined by market forces during the period rights are traded at the stock exchange. In a rights issue, the existing shareholders get the right to buy additional shares issued by the company. Since the additional shares are inevitably issued at a discount to the current market price, the rights issue can be compared to an in-the-money call option (Agarwal and Mohanty, 2012).
In describing the French market, Ginglinger, Matsoukis and Riva (2013) stated that firms can choose from two major Seasoned Equity Offering floatation methods: rights issues and public offerings. Various studies have been conducted on rights issues, covering different aspects of rights issues. Fung, Leung and Zhu (2008) studied evidence of earnings management in the Chinese market’s rights issues. Their findings supported the hypothesis that Chinese companies’ earnings are considerably manipulated in the rights issue process. According to Koenig (2012), rights offers are still the most frequent floatation method in Europe and Asia. The study found evidence of informed trading before and after a rights issue. They further demonstrated that informed traders are able to identify the issuer’s quality once all issue characteristics have been released.

Ursel (2006) found evidence that there are distressed firms that raise equity capital and invest, contrary to the view expressed in much of the finance literature that distressed firms avoid equity issues. The study also found that firms that made rights issues had significant improvements in their operational and financial performance. She suggested that this was evidence that rights issues are a rational vehicle for both investors and issuers.

Studies on rights issues have in the past presented two major challenges, that is, the rights issue paradox and the subscription price discount puzzle.

The rights issue paradox was raised by Smith (1977) and attempted to explain why rights offerings were used so infrequently in the United States when they provided lower direct floatation costs than other equity offerings. Smith (1977) attributed the paradox to agency problems between managers and shareholders that arise because managers derive personal benefits from using underwriters. Contributing to this, Ross, Westerfield and Jordan (2008) stated that rights offerings appear to be cheaper for the issuing firm than cash offers. They however found that despite this, they are not common in the United States, unlike in other jurisdictions. They concluded that this is a mystery that remains unresolved.

Holderness et al. (2012) attempted to explain the scarcity of rights offering in the United States compared with other countries in two ways; first, that shareholders in many other countries, including the United Kingdom, have a legal right to purchase their pro-rata share of any newly issued securities before they are offered to outsiders; and secondly, that wealth transfers in rights offerings are lower in other countries, and this in turn makes such rights offerings more attractive either to management or to shareholders. Uninsured rights incur reduced floatation costs, but limited market liquidity improvement although it may still be the
best method for firms with large block holders subscribing to the new shares and distressed firms. These results by Ginglinger et al. (2013) help to understand why firms choose public offerings despite higher apparent costs and therefore contribute to the resolution of the rights offer paradox.

The second major challenge is the subscription price discount puzzle faced by corporate managers when making rights issues. According to Duong, Singh and Tan (2012), managers are averse to setting low subscription prices. Heinkel and Schwartz (1986) explained this phenomenon by stating that low subscription prices for non underwritten offers signal low firm value in non-underwritten rights offerings. Contributing to the subscription price discount puzzle, Eckbo and Masulis (1992) found that capital gains taxes incurred on sale of rights and the triggering of convertible securities’ anti-dilution clauses when discounted rights are issued, may discourage low subscription prices.

In their study on how firms issue shares, McLean, Zhang and Zhao (2010) found their results consistent with the belief that managers aim to maximize shareholders wealth and this guides their decisions on whether to make rights or primary offers. They also found that rights issues generally involve more shares that other types of offers. These findings were in line with those of Heron and Lie(2004), who found that the mean(median) number of shares in a rights offering scaled by the total number of outstanding shares was 81.9%(35.2%), while for other types of offerings, neither the mean nor the median exceeded 30%. This is in line with the hypothesis by Doung and Tan (2011), that managers choose equity floatation methods that mitigate the risk of lost opportunity due to issue failure. Such floatation methods involve the lowest expected failure costs.

Security offerings are an important activity in the life of a firm. This is partly because of the typically large amount of new capital raised relative to an issuer’s existing capital base or asset size. Additionally, the decision to issue securities draws on all of the core areas in financial economics: asset pricing theory, capital structure theory, managerial investment incentives, financial institutions, contracting, and corporate governance. Unfortunately, there is surprisingly little consensus on key determinants of the security issuance decision and its economic effects on the firm (Eckbo, Masulis and Norli, 2007). They further state that firms mainly issue shares to raise capital for capital expenditures and new investment projects.
In line with the views of Eckbo et al. (2007), Iqbal and Strong (2010) state that raising additional equity, for example, through a rights issue, is an important event in the life of a firm. They noted that there has been little research on the corporate governance mechanisms in place to check opportunistic earnings management around specific corporate events for the UK market.

In their study on why firms choose value destroying rights offerings, Wu and Wang (2002) stated that the choice of floatation method in seasoned equity offerings is an important corporate financial decision. They observed that private placements and rights offerings were the major equity floatation methods in many stock markets. Companies either in growth or expansion need more capital than they are sometimes able to generate internally. They explore options of raising that additional capital and a Rights Issue is such an option. If the objectives are achieved, they should lead to the improvement of a company's performance and the prices of its listed shares at the stock exchange should go up.

According to Doung et al. (2011), other motives for making rights issues include: to refinance or replace existing or maturing securities, to modify a firm’s capital structure, to exploit private information about securities intrinsic value, to exploit periods when financing costs are historically low, to finance mergers and acquisitions, to facilitate asset restructuring, among others. According to Burton and Power (2003), firms make rights issues when the management believes equity is undervalued.

Eckbo et al. (2007) stated that equity offerings come in different forms such as: Initial Public Offers (IPOs); Seasoned Equity Offers (SEO); public offers and private placements. They further stated that the selling mechanisms also differ. They include; firm commitment underwriting contract, rights offering discriminatory or non-discriminatory auction, privatizations, carve-outs, employee stock ownership plans (ESOPs) and equity bonus plans.

In their study on the determinants of equity issue method in the UK, Burton et al. (2003), found that rights and non-rights issues have remained popular as methods of issuing equity for more than two decades. To distinguish between rights issue and private placing, they stated that while rights issues involve asking shareholders to further increase the proportion of wealth invested, placings result in diversified shareholding structures. They further noted that, firms can arrange a rights issue more quickly than a placing since no prospectus is
needed with a rights offer provided that the issue represents less than 10% of the firm's existing share capital. In addition, no shareholder or Stock Exchange permission is required.

Rights issues are generally rare in the United States compared to other markets. Smith (1977) found that they account for only 10% of all seasoned equity issues. On the contrary, according to Fung et al. (2008) rights issues play a more dominant role in Asian equity markets in general and the Chinese market in particular. Their study on rights issues in the Chinese market found that most companies prefer stock to bond capital sources. This they noted was due to the culture of debt avoidance as well as past experience with high debt ratios. For their study they found that 93% of the equity issues were through rights issues. They predicted that rights issues would remain a key source of capital for Chinese firms.

In their study on the pricing efficiency of stock rights issues in Malaysia, Sukor and Bacha (2010), noted that for listed companies in Malaysia, a secondary issuance of stocks is almost always in the form of a rights issue. This was similar to the findings of Burton et al. (2003) that the typical amount of funds raised through rights issues in the UK market is considerably larger than in other methods such as shares placement. Rights issues remain a common method for raising equity capital in Australia for companies listed on the Australian Stock Exchange (Barnes and Walker, 2006). They note that this trend is different from that in the US markets where public issues are more common. They further explain that this is attributed to the fact that the US capital markets encourage dispersed ownership and have a strong emphasis on market liquidity, which is best achieved through public issues. In France, unlike in the U.S., the most common flotation method is a rights issue in which short-lived warrants (rights) are issued to current shareholders on a pro-rata basis. During rights issues, shareholders have to decide whether or not to subscribe to the new equity offering. They can either subscribe to the offer by exercising their rights or sell them on the open market during the subscription period, thereby, accepting a reduction in their firm ownership.

McLean et al. (2010) found that public offerings were the most common type of issue, followed by private placements, stock-financed mergers, and finally rights offerings. Their findings were not in line with the common belief that excluding the U.S, seasoned shares are issued primarily through rights offerings or private placements.
Their findings also failed to support the phenomenon that rights issues have declined internationally. The percentage of firms making rights issues increased during their study period. Heron et al. 2004 suggest that firms sell equity in regular offerings to take advantage of temporarily high equity values, while firms sell equity in rights offerings or file shelf registrations when their market value is low and their financial situation tight. In line with these were the findings of Ursel (2006) that rights issues are a last resort means of financing for firms in distress.

According to Moss, Ramachandran and Standley (2007), equity markets in sub-Saharan Africa are small and relatively illiquid. They however observed that Africa had made significant progress in developing its domestic capital markets. Their findings support those of Piesse and Hearn (2005), who noted that many African stock exchanges were making progress despite being highly illiquid. Moss et al. (2007) noted that there was improved information on African markets, regulatory and financial sector reforms implementation, and that countries were beginning to adopt modern technologies such as automated trading and central depository systems.

Firms intending to make rights issues must get the approval of shareholders. This is usually done at the annual general meeting or an extra ordinary general meeting, convened for that purpose. In addition to this, approval is also obtained from the Nairobi Securities Exchange and the Capital Market Authority. After all the relevant approvals are obtained, the firm can proceed with the rights issue. This involves sending out the information memorandum document to all its shareholders. The document contains details of the key features of the offer, such as, the subscription price, number of shares on offers, number of rights required to purchase a share, key timetable of the offer, and application procedures. It also gives an overview of the company including its performance record and future plans. The Provisional Allotment Letter (PAL), is attached to the information memorandum, and is used by shareholders in making applications for the offer, (http://www.cma.or.ke).

Rights are traded at the NSE on the Automated Trading System (ATS), much like corporate bonds, treasury bonds and equities. Trading of rights occurs until the date at which the new shares can be purchased.
1.2 Problem Statement

Research on rights issues has been conducted in various jurisdictions around the world. The seminal work in this area was done by Smith (1977) who introduced the concept of the “rights offer paradox”. Subsequent to that study there have been various studies addressing the issues first raised by Smith (1977) as well as other pertinent issues. Some of the areas that have been covered by existing literature include: financial performance of firms after rights issues; effect of underwriting on the success of rights issues; pricing efficiency of rights; announcement effects and long run effects of rights issues; earnings management and choice of equity issuance methods. Don, Bray and Peterson (2009), investigated the effect of the intended use of rights issue proceeds on the long run performance of a firm. They found that the use of issue proceeds for investment led to little or no underperformance. An earlier study by Lukose and Rao (2003) sought to investigate the performance of firms after rights issues. In their study of companies listed on the Bombay Stock Exchange (BSE), they found that performance declined especially in the five years subsequent to the rights issue. They attributed the decline to inefficiency in resource utilization, and not decreased profit margins.

Harris (2004) in investigating UK firms also found that they underperformed following rights issues. In contrast to the above findings, Ursel (2006) found that U.S firms showed improved operating and financial performance followings rights issues. She concluded that rights issues were a means to corporate recovery for firms in financial distress. The study also found that there had been revival of rights issues by firms in poor financial condition. Barnes (2008) noted that rights issues have greater potential to enhance liquidity and reduce ownership concentration. While studying rights issues by UK companies, he observed that there was a lot more literature on equity issues by U.S companies compared to UK companies. He observed that the four major determinants of equity issue methods selected by firms were: the institutional characteristics of the market in which a firm operates; the specific characteristics of the issuer and the issue; the need for control of ownership and proprietary information.

Balachandran, Faff and Theobald (2009), studied the effect of the underwriting status on shareholder take up. Their study of Australian companies found that fully underwritten issues had a higher take up, than non underwritten or partially underwritten issues. Fung et al. (2008) noted that rights issue was the most prevalent equity issue method in the Chinese market. They investigated and found evidence of earnings management around rights issues.
Holderness et al. (2012) contend that even though rights offerings are one of the three major ways to raise equity around the world and is perhaps the oldest method, our knowledge of them remains incomplete. Despite this knowledge gap, very few studies have been conducted on rights issues in Africa, compared to other jurisdictions such as the U.S, Europe and Asia.

Most of the studies in Africa have addressed the issues of stock market integration, such as the study by Jefferis and Smith (2005). Osamwonyi and Kasimu (2013) and Odhiambo (2005) studied the relationship between stock market development and economic growth. A similar study was also conducted by Mwaura, Ngugi and Njenga (2009). According to Enisan and Olufisayo (2009), the stock market development is co-integrated with economic growth in Egypt and South Africa suggesting that stock market development has a significant positive long run impact on economic growth. They argued that stock markets could help promote growth in Africa.

Despite the small number of rights issues in Africa compared to other parts of the world, they have been receiving positive reactions and more and more firms have embraced them as a source of finance. Yartey (2009) observed that the stock market is an important source of long term external finance. He predicted that the development of this market would shift firms in Ghana to using more equity and less debt. Piesse et al. (2005) found that in a number of African countries, the emphasis on growth and development had shifted from a bank-based system to one that is dependent on capital markets as a source of finance for the business sector. They noted that this had led to the establishment of a number of new stock exchanges and the restructuring and reform of many of the existing ones.

Information from the Kenyan regulator, the Capital Market Authority, reveals that there has been growing interest in use of rights issues by Kenyan firms. Some of the research that has been done includes: effect of firm profitability and timing on rights issue choice: effect on share price subsequent to rights issue and effect of firm characteristics on choice of rights issue to raise finance. This study sought to contribute to and extend the existing literature by investigating the benefits and challenges associated with rights issues. In addition, the factors affecting their success and measures that can be taken to enhance their use were studied. The study is therefore not only relevant, but also a timely one.
1.3 **Objective**  
The general objective of the study was to investigate the use of rights issue for corporate financing in Kenya.

1.4 **Specific Objectives**  
The specific objectives of the study were to:

1.4.1 Determine the factors that lead to the choice of rights issues in raising capital.
1.4.2 Establish the factors that influence the success of rights issues.
1.4.3 Determine the challenges that firms encounter when using rights issues.
1.4.4 Determine the measures can be taken to enhance the use of rights issues in raising capital.

1.5 **Importance of the Study**  
The study is important for the following groups:

1.5.1 **Scholars**  
There exists a lot of literature on rights issues for markets in the developed and emerging economies such as the United Kingdom, United States, Australia and Malaysia. However, not much work has been done to address this topic in the developing countries specifically, Kenya.

The study has contributed to the body of existing literature, while shedding more light on the Kenyan context.

1.5.2 **Corporate Organisations**  
Firms that made rights issues in the past will benefit from the study and draw lessons for use during future issues. Firms wishing to make rights issues for the first time will have a head start in knowing the key factors to consider.

1.6 **Scope of the Study**  
The population for the study comprised all the rights issues made in the Kenyan market for the period 2004 to 2012. This number was 18 as at December 2012. The issues were made by a total of 11 firms, as some of them made repeat issues (http://www.cma.or.ke).
1.7 Definition of Terms

1.7.1 Rights Issue
A rights issue is an invitation to existing shareholders to purchase additional new shares, in proportion to their shareholding. It is also referred to as a rights offer or rights offering (Arnold, 2008). Each shareholder gets an option to buy a specified number of shares at a specified price within a specified time, after which the rights expire (Ross, Westerfield and Jordan, 2008).

1.7.2 Subscription Price
The price at which a company makes rights issues to its shareholders. It is typically lower than the prevailing market price. It is also known as the offer price (Broyles, 2003).

1.7.3 Preemptive rights
The right of current shareholders to maintain their proportionate ownership in the firm after a rights issue (Mayo, 2010).

1.7.4 Subscribe
To subscribe for an issue is to undertake to buy the offered shares (Broyles, 2003).

1.7.5 Oversubscription
Shares are said to be over subscribed when investors offer to buy more shares than are made available by the issuing firm (Arnold, 2008).

1.7.6 Seasoned Equity Offerings (SEOs)
New equity issues by firms that already have common stock outstanding (Smart, Megginson and Gitman, 2004).

1.7.7 Provisional Allotment Letter (PAL)
A letter sent to each shareholder stating the number of shares provisionally reserved or allotted to them for purchase in a rights offering (Broyles, 2003).

1.8 Chapter Summary
This chapter introduces the concept of corporate financing and the various options that are available to organizations. It highlights the use of rights issues as one of such alternatives and presents the key distinguishing factors from the other sources of finance. A background of the concept of rights issues and the areas that have been addressed by existing literature is
also discussed. The prevalence of rights issues in the Kenyan market is addressed, while highlighting its contribution to the overall development of the capital market.

Chapter 2 will present a review of existing literature on rights issues. Chapter 3 will describe the research model used to conduct this study. Chapter 4 will present and discuss the findings of the study. Finally, Chapter 5 will present the conclusions drawn from the study.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction
This chapter presents the findings and observations from various studies conducted on rights issues. These are drawn from various markets around the world. The chapter is organized into four sections as follows: Section 2.1 discusses the factors that lead to the selection of rights issues; Section 2.2 analyses the factors that influence the success of rights issues; Section 2.3 discusses the challenges encountered when making rights issues and Section 2.4 addresses the measures that can be taken to enhance the use of rights issues. The final part Section 2.5, summaries the results and conclusions drawn from the studies conducted on rights issues.

2.2 Factors That Lead To Selection of Rights Issues

2.2.1 Relatively Lower Floatation Costs

According to McLaney (2006), rights issues are a relatively cheap way of raising capital for a quoted company. They further stated that this was because certain costs involved in making new shares such as brochure preparation, are avoided. In line with this, McLaney (2006) specifically found that the issue costs of UK rights issues between 1985 and 1996 averaged 5.8% of the funds raised. In contrast to these findings however, Ginglinger et al. (2013) found that despite the low direct costs associated with rights issues, they may involve indirect costs that could make total costs higher for some issuers. Their study was based on the French stock market where the major equity issue methods are rights issues and public offerings.

Similarly, Armitage (2007) found that the cost of selling blocks of rights is substantial in the case of less liquid shares and represents a hidden cost of the rights issue method. The choice of a floatation method depends on the characteristics of the firm. The rights offer paradox (Smith, 1977) highlights the more prevalent use of costly underwritten floatation methods as opposed to the cheaper rights issues by most U.S firms. Floatation costs are a major determinant in the choice of equity offering, because they determine the net proceeds of the issue.

Earlier studies by Eckbo and Masulis (1992) and Eckbo and Norli (2004), showed that if existing shareholders plan to retain most of their new shares, then rights offerings provide the
cheapest method of issuing shares. Expected floatation costs vary across firms and are determined by the issuer’s characteristics and the type of security offered. To accurately determine the expected floatation costs of a rights issue, Eckbo et al. (2007), stated that the unique firm characteristics should be understood. They further classified floatation costs into two; direct and indirect costs. Directs costs include: underwriting fees; legal fees; accountants’ fees; listing fees; printing and advertising costs. Indirect costs include: underpricing the issue, stock price reactions to issue announcements, and the cost of delays or cancellations of rights issues.

According to Eckbo et al. (2007), under pricing is the most important indirect floatation cost in a security offering. Underpricing may be measured by comparing the offer price to the closing price on the prior trading day or on the first trade day following the completion of a security offering. The offer price relative to the closing price on the offer date is generally termed the under pricing level.

There exists an unresolved debate on the announcement effect of a rights issue as an indirect cost. Eckbo et al. (2007) observed that a rights issue announcement conveys information already known to firm managers, and should therefore not be considered an issue cost. In contrast, the announcement effect is deemed by some researchers as having direct and indirect effects on the cost of raising new equity. According to Sukor et al. (2010), the underwriting cost of a rights issue is related to the announcement period returns. Owen and Suchard (2008) found that underwriting cost is significantly positively related to announcement returns.

2.2.2 Preservation Of Ownership And Control
During rights issues, existing shareholders are automatically entitled to participate in proportion to their ownership stake at the time the issue is announced. Typically they may be entitled to subscribe for one new ordinary share for every X ordinary shares already held and fully ranking for dividend rights. In the UK, this ‘pre-emption right’ is both enshrined in company law and in the stock exchange rules and is designed to protect shareholders from a dilution of their cash flow and control stakes in the firm, through subsequent issues to new investors.(Barnes et al.,2006).

Rights issues are driven by the need to avoid dilution of ownership, Sukor and Bacha (2010). However, ownership dilution could occur if a shareholder fails to exercise his/her rights.
According to Breuer (2006), subscription rights for rights issues make it possible to have subscription prices below the corresponding secondary market prices without necessarily creating a wealth transfer from old to new shareholders. This is because new shareholders are forced to pay old shareholders for subscription rights if the equity shares are to be bought on the primary capital market.

In support of the importance of control value, Wu et al. (2002) found that the announcement of rights offerings causes a larger drop in the stock prices of the issuer when the pre-issuance firm-specific market condition looks poorer, an unfavorable situation for new equity issues. They however added that regardless of whether the ownership profile changes because of ownership dilution or otherwise, rights issues will entail a ‘value’ dilution on a per share basis. They explained that immediately following the rights, the number of shares outstanding increases though the firms’ assets, cash flows and other operating fundamentals remain unchanged. As such, value on a per share basis is diluted immediately following new stock issues. They referred to this as economic dilution.

In France preemption rights accrue to shareholders, and they cannot be permanently waived by means of charter amendment (Ginglinger et al., 2013). The Indian Companies Act requires the directors of a public limited company, to first invite existing shareholders, whenever they offer further shares. If a shareholder does not wish to participate, they can renounce their rights in favour of another person. This right of renunciation is mandatory, unless the articles of the company provide otherwise (Lukose and Rao, 2003).

Holderness et al. (2012) found that nations such as Sweden and Italy have institutional protections that limit wealth transfers in a rights offering. In these jurisdictions, brokers have selling rights when shareholders do not take up the invitation to participate in a rights offering. They further observed in the United Kingdom and Netherlands, when some rights are not exercised, the investment bank sells them in the market. The net proceeds are credited to the nonparticipating shareholders’ accounts. Their results also revealed that the United States and Israel had the fewest protections for non participating shareholders, and found that rights offerings were rare in the two countries.

According to Cronqvist and Nilsson (2005), rights issues deliver the benefit of preserving ownership concentration and hence control, in closely held firms. When financing new investments with new equity, placements dilute managers or controlling shareholders’ equity
holdings and thus weaken their control on the firm, whereas rights issues do not. Thus, if private benefits are large, it is crucial for the incumbent managers/controlling shareholders to carefully control the change of ownership structure in order to prevent the loss of private benefits (Wu et al., 2002). They further noted that managers or controlling shareholders are willing to bear a substantial value loss on their own equity holdings in rights issues to protect control value. Consequently, the choice of floatation methods can signal the level of private benefits of control in the firm. The signaling cost is the expected loss of private benefits of control.

Mclean et al. (2010), contend that weak investor protection encourages entrenched owners to make rights issues, so that their ownership and the benefits that it provides them are not diluted. Despite this, wealth transfers could occur in some instances. According to Holderness et al. (2012), there is wealth transfer from those who do not participate to those who participate in a rights offering. Consequently, it is recommended that shareholders who do not wish to exercise their rights should sell them to avoid this wealth transfer. There is a non-linear relation between shareholder participation and wealth transfers among shareholders. If all shareholders participate, there will be no wealth transfers. Likewise, if no shareholders participate, there will be wealth transfers.

2.2.3 Rights Issues Are Fairly Certain

Rights issues generally offer a high level of certainty when raising equity capital because a firm can tap an already existing market for its shares, while those who do not wish to take up the rights can sell them in the market. McLaney (2006), observed that in practice, rights issues rarely fail and showed that the high success rate was important as most issue costs are pre-committed and thus are lost if rights fail. It can be presumed that, management decides to make rights offerings only when they are reasonably confident of raising the funds sought.

According to Heron et al. (2004), firms can self insure by setting low subscription prices. They however stated that this does not guarantee non failure of a rights issue. To complement this, they recommended the use of subscription pre-commitments. Ross et al. (2008) contend that only a small percentage of shareholders (less than 10%) fail to exercise valuable rights. In contrast, Holderness et al. (2012) found that only 64% of shareholders participate in valuable offerings.
Heron et al. (2004) further found that the incentive for managers to manipulate earnings prior to rights issues were weaker or non existent if the firm is not raising equity from new shareholders. They noted that any upward earnings management before or around equity offering announcements was limited to offerings of primary shares and combinations of primary and secondary shares, and found no evidence of upward earnings management around rights offerings and shelf registrations.

Holderness et al. (2012), contend that although many rights offerings indeed raise most or all of the target capital, shareholder participation is sometimes quite low. This discrepancy arises because some shareholders purchase more than their pro rate share by participating in an oversubscription round. Duong et al. (2012) hypothesized that corporate managers choose equity floatation methods that mitigate the risk of lost opportunity due to issue failure. They thus choose methods with the lowest expected failure costs.

According to Breuer (2006), since higher loss aversion should typically increase the level of uncertainty avoidance, it would be expected that countries like Germany and Italy should be characterized by higher uncertainty avoidance than the US, the UK, and the Netherlands. He found this to be the case.

The model by Eckbo and Masulis (1992) reported that take-up rates for rights offerings in the United States were close to 100%. Heron et al. (2004) found that the abnormal returns for insured rights offerings were not as unfavorable as those for firm commitment offerings. Bohren, Eckbo and Michalsen (1997) and Singh (1997) also found evidence consistent with the prediction of Eckbo et al. (1992) that high shareholder take-up is an important determinant of the rights offering decision.

### 2.2.4 High Stock Prices

According to Heron et al. (2004), management only issue new shares when the market overvalues the shares relative to the beliefs of management. They stated that the fact that earlier studies indicated that firms offer common equity after a period of superior stock price performance, is only true for firms that subsequently complete their offering. Their results showed that these firms have superior stock price performance prior to the announcement of equity offerings.

This finding was in line with that of Thenmozhi, Malhotra, and Arun Kumar (2007), who concluded that the share price should not fall if the firm issues safe debt (default and risk-
free) to finance investment. This is because, based on the assumption that managers act on behalf of existing shareholders, rational investors presume that managers issue new shares only when they believe the stock is overvalued. Similarly, Lukose and Rao (2003) stated that managers issue equity only when it is overvalued. They explained that the reason for this was that managers prefer debt to equity if in need of external funds, because when issuing equity, underpricing may lead to erosion of old shareholder’s value.

In contrast to the above, Holderness et al. (2012), stated that, if the major reason for issuing shares is to take advantage of overvalued equity, this would explain the rather limited use of rights offerings. Modigliani and Miller (1958) showed that in the absence of information asymmetries and taxes, the manner in which firms finance their investments is irrelevant. They also found that when managers believe that the capital market undervalues the firm’s equity, the optimal financing choice is to issue risk-free debt or use a pre-emptive stock issue.

The issue of information asymmetry was expanded by Myers and Majluf (1984) who developed an adverse selection model which assumed that managers are more informed about the firm’s prospects than potential investors. They further stated that investors, recognizing their informational disadvantage, interpret equity issues as a signal that the firm is overvalued. Thus, firms only issue stock when they have exhausted their internal funds and debt sources and/or when managers indeed believe that the stock is overvalued.

2.2.5 Favorable Regulatory Requirements

According to Lukose et al. (2003), the financial sector reforms initiated in 1992 and a number of policy initiatives from the Government of India resulted in exponential growth in the securities market in India in terms of amount raised from the market, number of stock exchanges and other intermediaries, the number of listed stocks, market capitalization, trading volumes and turnover on stock exchanges, and investor population. They further observed that the market had witnessed fundamental institutional changes resulting in drastic reduction in transaction costs and significant improvements.

In Malaysia, Sukor et al. (2010) observed that it was mandatory for new equity offerings to be offered to existing shareholders in the form of rights before being offered to other parties.
McLean et al. (2010) suggested that investor protection is necessary for domestic diversification to be beneficial. Consequently, when shareholders are too controlling, there are fewer incentives to sell large parts of the firm in weak investor protection countries. On the correlation between rights issue and level of market activity, McLean et al. (2010), found that the choice of rights issues versus other types of share issues is not a function of how large or active a stock market is.

Armitage (2000) observed that the London Stock Exchange Listing Rules prohibited a placing if price was at a discount of more than 10% to the middle market price of those shares at the time of the placing (Listing Rules, LSE, Section 4.11). He concluded that prevailing market conditions, particularly in respect of volatility and information asymmetry, may dictate that a new issue be brought to market at a significant discount to prevailing market price, and this obviously narrows the range of flotation choice available to managers, rendering the effective decision beyond managerial control.

In their study of the Chinese market, Fung et al. (2008) observed that the regulations for rights offerings were adhoc, thus providing an incentive for earnings management. They further noted that the rights issue regulations required firms to have at least 10% return on equity over a three year average, and to use the proceeds for new projects or expand existing projects. They posited that the objective of these regulations was to limit the demand for rights issues, optimize allocation of funds and avoid the negative impact of rights issues on the secondary market.

2.3 Factors Affecting The Success Of Rights Issues

2.3.1 The Subscription Price
Sukor et al. 2010 observed that while some of the earliest works on the pricing of rights included those by Giguere (1958) and Kassouf (1968), it was the work of Smith (1977) that is often cited as the seminal work in pricing of rights. He was the first to recognize that the valuation of an underwritten pure right is simply the valuation of a call option on the stock modified to reflect the dilution that occurs when the rights are exercised.

The subscription price must be set lower than the current market price, to reduce the risk of the market price falling below it. If the market share price were to fall below the rights issue price, the issue would not have much chance of being a success, since shareholders could buy the shares cheaper in the market than by taking up their rights to buy through the new issue.
This is supported by the observation of Fung et al. (2008) that, setting a low subscription price relative to the market price reduces the risk that the market price will fall below the subscription price, and increases the chances of higher take up. They also found that higher firm subscription price appears to be associated with greater positive abnormal returns, and larger firms will have smaller abnormal returns. Holderness et al. (2012) stated that rights issues were priced at a discount to provide an incentive for shareholders to participate.

The offer price discount is instrumental both in explaining market reaction to equity issue decisions and in influencing a firm’s choice of the equity floatation method (Armitage, 2002). Burton et al. (2004) observed that firms are reluctant to use deeply discounted rights issues (DDRIs). They also found that firms tend to set the subscription price as close as possible to the market price irrespective of the effect on underwriting cost. There is a large loss of value for companies announcing deeply discounted offers, which is attributed to release of bad news on announcement (Armitage, 2002).

Pricing of rights remains a challenge that issuers have to carefully address. In a study on the pricing efficiency of rights in the Stock Exchange of Singapore, Poitras (2002), found the rights issues to be underpriced. In a similar investigation of the pricing efficiency of rights in Malaysia, Sukor et al. (2010) found that the market was inefficient in pricing, with overpricing being very common. They used two alternative valuation models, the adjusted Black–Scholes Call Option Model (BSOPM) and the traditional Implied Rights Valuation Model (IRVM), to conduct their investigation.

In countries where rights issues are common, firms use strategies to manage the expected cost of failure of the issues. Duong et al. (2012) found that firms in the Singapore market used the strategy of setting subscription price discounts that are more that three times those of firms in the United States. Eckbo et al. (2007) observed that in the Norwegian market, issuers were required to set subscription prices at least three weeks prior to the commencement of the issue. After factoring the two week issue period, issuers would have to forecast the market price, at least five weeks ahead of the final offer price. The long prediction period would likely increase the risk of failure of the issues.

The key to a successful rights offering, where the issue is fully subscribed is the subscription price (Shapiro and Balbirer, 1999). According to Duong et al. (2012), the subscription price
discount puzzle has been one of the challenges experienced in studies on rights issues in the last three decades. Earlier studies in this area concluded that corporate managers are averse to setting low subscription prices. This was attributed to the need to shield shareholders from high capital gains taxes as well as the likelihood that low subscription prices, signal low firm value for non underwritten offers.

However, Duong et al. (2012) did not find evidence of this in their study. Instead they stated that firms with valuable projects were more likely to set larger subscription discounts to insure against failure of the issue. They further argued that, the subscription price can signal the value of a firm’s growth opportunities rather than that of its assets. From their study, Fung et al. (2008) concluded that companies would be able to raise more capital by having lower allocation ratios and higher subscription prices. They stated that high subscription prices sent positive signals to shareholders about the firm’s value and performance. McLaney (2006), stated that pricing rights at a discount put pressure on existing shareholders to take up their shares or sell their rights. When either of the options was taken, the chances of success of the rights issue were high, in terms of shares taken up and amount of capital raised.

2.3.2 Degree Of Ownership Concentration

Evidence from various studies suggests that rights issues are more prevalent among firms having concentrated ownership. In her study, Ursel (2006) observed that rights issues were used by firms with high ownership concentration, where insider take-up of the rights was expected. This finding was in line with that of Faccio and Lang (2002), who found that a distinctive feature of French firms was the high concentration in ownership.

Ginglinger et al. (2013) found that in the United States, utilities, closed-end funds, REITS, and more recently financially distressed firms were the primary users of rights offerings. This finding supports the findings of Heron et al. (2004) and Ursel (2006). Ginglinger et al. (2013) further found that in contrast to the above findings, large publicly traded corporations were the main issuers of standby rights in the France market. According to Holderness et al. (2012), institutional ownership had a strong, negative association with nonparticipation. Larger institutional ownership was associated with lower nonparticipation. They observed that institutions seemed to fully participate and perhaps even oversubscribe.

Heron et al. (2004) found that issuers of uninsured rights had more concentrated ownership and high levels of pre-commitment. They found that the mean(median)block holdings was
50%(50%) for firms that use uninsured rights and 27%(19%) for firms that use insured rights, while the mean(median)pre-commitment is 53% (50%) for uninsured rights and 5%(0%) for insured rights. Their findings were supported by Duong et al. (2012), who observed that an increase in firm ownership concentration, increased subscription pre-commitment, since it was less costly to solicit and procure subscription pre-commitments. They concluded that the increasing scarcity of uninsured offerings in many countries, including most notably the United States, was coincident with decreasing ownership concentration for firms in these countries. They further stated that diffuse ownership concentration in turn implied low subscription pre-commitment and a high probability of uninsured issue failure, which could result in firms shunning the uninsured offering.

Barnes et al. (2006) noted that in the United States market, policy explicitly favoured dispersed ownership, and public issues facilitated this. Wider ownership and consequently greater trading volumes enhanced liquidity, reducing trading costs through the reduction in bid-ask spreads, which are typically smaller for widely and frequently traded shares than for those more closely held. In their study of the Chinese market, Fung et al. (2008), found that more investors subscribed to offerings with high participation of non individual investors. They however observed that state and legal shareholders were more likely to let their rights expire for lack of cash, leading to under subscription. This was fortunately mitigated by the window provided by the National Administration for State Assets in China, for state shareholders to subscribe using tangible assets such as product lines, plants, and land use rights, or to veto the plan if they lacked cash and considered the issue detrimental to their interests. The findings of Fung et al. (2008) indicated that Chinese investors could rationally predict that a higher participation of state and legal-person shares provided more information about firms’ earnings, and thus generated a more positive reaction to the rights offerings.

In a study of rights offerings in Finland, Rantapuskka(2005), found that individual investors were most likely to allow their subscription rights to lapse, while financial institutions were the least likely to do so. They also found that among financial institutions, mutual funds always exercised their rights.
2.3.3 Underwriting

Holderness et al. (2012) suggested that one of the steps that a firm could take to ensure that a rights offering is successful, would be to have an investment bank underwrite it, by guaranteeing to buy any shares not taken up by shareholders. Their study found that only 6% of the offerings were underwritten. They further found that another alternative is to have a standby buyer; usually an existing large shareholder in the firm or an outsider, who similarly agrees to buy any unexercised shares. Their study found that this was present in 25% of the offerings studied. Although a firm in theory could have both an underwriter and a standby buyer, they did not find this in any of the offerings studied, possibly because of the possible cost replication.

Non–underwritten rights issues are also called uninsured rights issues. Firms making non underwritten issues avoid paying underwriter fees by marketing the new shares through current shareholders. Consequently, the gross proceeds of the rights offer are not guaranteed. When firms use underwriters to certify their issues they communicate to the market that their stock is accurately valued. Underwriters must ensure that issues are neither underpriced nor over priced, since either scenario would lead to a loss of market share. Heron et al.(2004) found that uninsured rights offers in their sample produced a larger proportionate increase in equity capitalization than insured offers. Their results corroborated the findings of Eckbo and Masulis (1992).

Some markets require that firms make only underwritten rights issues. Fung et al. (2008) observed that there was a requirement for rights issues in the Chinese market to be organized by an underwriter or an underwriting group. The underwriter would be required to make a commitment to buy rights not taken up. According to Holderness et al. (2012), whether or not an offering has an underwriter or standby investor has a strong association with take-up. According to Duong et al. (2012), when firms expect a high take up, they are less likely to have their issues underwritten. They found their results consistent with the argument that corporate managers use underwriters to guarantee the proceeds when there is a high probability of failure for an uninsured issue.

Ursel (2006) posits that firms in poor financial condition issue non underwritten rights. This, she found would be the only available avenue to raise equity for such firms. According to her, such firms are not able to attract underwriter services, due to their high cost and unwillingness to participate. Her study found that underwritten rights issues had declined
over time. She contended that when firms used underwriters, they conveyed the message that the stock was not overvalued. The resulting reduction in adverse selection costs must outweigh the underwriting fee. High value firms benefit from underwriting because it is much easier and less risky for underwriters to certify them. Consequently for low value firms, the unwillingness by underwriters to participate would result in very high underwriting fees.

According to Eckbo (2008), as the expected shareholder take-up falls probably because increases in corporate size cause risk-averse, wealth-constrained shareholders to diversify their investments, the potential for costly wealth transfers from issuing mis-priced equity leads companies to consider underwriter certification of the new issue. They noted that there had been a switch by companies in all developed economies from pure rights to underwritten offers, as growth led to less concentrated ownership structure.

### 2.3.4 Current Trend And Tone Of The Stock Market

When an economy booms, it is easier for firms to find investment opportunities and these investment opportunities are highly correlated with the growth of the overall economy. Choe, Masulis, and Nanda (1993) found that the volume of equity offerings is indeed higher in economic expansions than in recessions. Mclean et al. (2010) found that firms in weak investor protection countries are more likely to issue shares by rights offerings. They found this consistent with previous studies. They further stated that this could be due to the fact that the public is unwilling to buy shares because of low levels of investor protection.

The probability of a rights offering increases with the debt ratio and decreases with the market value of equity, market run up, industry-specific run up, and stock-specific run up. The probability of a shelf registration increases with the debt ratio, the market value of equity, and the market run-up and decreases with the industry-specific run-up and the market-to-book value of assets (Heron et al., 2004). These results are generally supported by their earlier findings and interpretations that, firms that use rights offerings as a means to sell equity have high debt ratios, suggesting a need for an equity infusion, but neither the overall market, the industry, nor the firms’ stock has performed well during the last year, such that a regular equity offering seems less appealing.

Fung et al. (2008) observed that the number of public offerings in the Chinese market had grown due to less stringent issuing requirements and better fund raising ability. They found that rights issues constituted the main type of public offering and predicted that it would
continue to be a key source of equity funds. Rights issues should monitor the market price trend and accurately forecast future trends. In addition to monitoring the specific stock, the general price trend should also be monitored. When the trend is unstable, for instance as a result of political factors, rights issues may not be successful. Conversely where the market is stable and the firm’s share price is on an upward trend, a rights issue is more likely to yield the targeted funds. Balachandran et al. (2009), found evidence that, the market response is most positive (or least negative) in the case of non-renounceable, full standby rights issues with relatively low price discounts. The market reaction is most negative for non-renounceable, partial standby issues with high price discounts.

2.3.5 Shareholder Take Up

This is computed as number of shares (or units of security being issue) sold to current shareholders as a fraction of the total shares issued. A simple measure of shareholder participation is the percent of rights that are exercised in the primary round before any oversubscription or over-allotment (Holderness et al., 2012). They further define shareholder take up as the proportion of an offering purchased by the original (and presumably informed) shareholders. Shareholder take-up differs from shareholder participation. For example, an offering may have low shareholder participation but high shareholder take-up if some shareholders purchase more than their pro-rata share. This is possible in offerings with oversubscription provisions, and these are found in most domestic offerings. Similarly, participation may differ from take-up if there is a standby buyer or if shareholders sell their rights to outsiders (Holderness et al., 2012).

Heron et al. (2004) relied on the model by Eckbo et al. (1992), which suggested that expected shareholder take-up is an important determinant of the rights offering choice. Other studies by Bohren, Eckbo and Michalsen (1997) and Singh (1997) also reported evidence consistent with the prediction of Eckbo et al. (1992) that high shareholder take-up is an important determinant of the rights offering decision. According to the latter, the lower the proportion of expected shareholder take-up, the greater the adverse selection problem, reducing the likelihood that managers will choose a rights offering

According to Holderness et al. (2012), participation tends to be lower for non-transferable offerings, non-stock offerings, and flexible-price offerings which sell stock at a price that is guaranteed to be at a discount to the exchange price. They further observed that most rights
issues come with the oversubscription provision. 77% of the rights issues they studied had this provision. The oversubscription provision gives shareholders the option of buying more than their pro rata share, if some shareholders fail to exercise their rights. According to Ross et al. (2008), the oversubscription privilege minimizes the likelihood of a rights issuer turning to the underwriter to take up unsubscribed shares. Closely related to this is the overallotment provision that may be present in some offerings. It gives firms the option to raise more than the initial target capital, if all shareholders participate.

Holderness et al. (2012) found that even after controlling for shareholder take-up, shareholder nonparticipation was associated with less capital raised (as a fraction of capital sought), greater wealth transfers, and more negative stock-price reactions. They also found that shareholder nonparticipation lead to wealth transfers averaging 7% of the capital raised or almost 5% of firm value. Their findings that the stock-price reaction to the announcement of a rights offering is mildly negative, were consistent with those of previous studies. They concluded that larger expected wealth transfers among shareholders were associated with more negative stock-price reactions, resulting in different levels of take up.

2.3.6 The Purpose For Which Funds Are Raised

In their study on the intended use of proceeds and its effects on long run performance Don et al. (2009), observed that issuers with specific plans to use the proceeds for investment purposes signalled profitable investment opportunities, whereas issuers without specific investment plans were more likely to be opportunistic market timers. They classified the intended use of proceeds into; investment, recapitalization and general corporate purposes. Their findings were that firms stating recapitalization or general corporate purposes experienced abnormally poor performance in the subsequent three years, but issuers stating investment had little or no subsequent underperformance.

Fung et al. (2008), found that firms were expected to use rights issue proceeds to finance new or expand existing projects. Expansion or investment plans were more attractive than rescue or debt pay off plans. Firms could make rights offerings to reduce debt, to finance acquisitions or internal projects. The debt reduction motive could be aimed at restructuring the balance sheet and preventing further fall in share prices. Firms that seek to reduce debt have poor performance in the period before the announcement.
Eckbo (2008) documented that financially distressed companies had a preference for rights offers. Eckbo noted stated that they used this source of funds as a last resort. This evidence was in line with the findings of Ursel (2006) who found that there was an increase in use of rights as a form of last resort financing for financially distressed firms. She further found that the rights issues were not underwritten due to the cost and unwillingness of underwriters to be involved. Ursel noted that since financially distressed firms had little to lose, they proceeded with non underwritten issues, regardless of ownership concentration. The observation was that, while they were likely to have a higher failure rate following equity financing, rights issuers also showed significant signs of operating recovery and reduced distress after the financing. This provides evidence that rights usage is a means of financial recovery for troubled firms.

2.3.7 The Performance Of The Firm

There are various characteristics of a firm that could affect the choice or success of rights issues. According to Burton and Power (2003), these include: profitability; size; liquidity; growth; dividend policy and shareholder structure. In a study conducted on Australian companies, Balachandran et al. (2009), stated that companies could choose from among three different types of rights offerings: full standby (also known as “fully underwritten”); uninsured (or “non-underwritten”); and partial standby (“partly underwritten”). They further stated that each of these three kinds of rights offerings can be either renounceable or non-renounceable, with the former providing securities that can be sold while in the latter case the rights are forfeited if not exercised.

Managers effectively signal the quality of their company through their choice of rights issue method. Consistent with this argument, Balachandran et al. (2009), summarized the findings of their study showing that high-quality companies tended to choose full standby rights issues, with the full backing of an underwriter playing a “certifying” role for investors. By contrast, low-quality firms tended to use partial standby issues with large subscription price discounts, while companies of intermediate-quality chose uninsured rights issues.

Bringing new issues of shares successfully to market necessarily involves advertising and dissemination of firm-specific information to existing shareholders and to the wider market. Where firms have information of a commercially sensitive nature, protection of such potentially value-relevant information must be a priority. If certain issue approaches facilitate
this process, it is likely that firms for which information effects are important may exhibit a preference for such methods (Barnes et al., 2006).

A record of strong past performance would render the market more willing to take firm briefings at face value and to attach credibility to firm specific information releases in respect of potential growth developments. These firms would therefore find it easier to make rights issues, as the targeted proceeds would be guaranteed. Firms without a strong performance history would need to issue rights at a significant discount to prevailing market price in order to market a seasoned issue successfully (Barnes, 2008).

Heron et al. (2004) found that firms that use rights offerings and shelf registrations faced tight financial situations, as their leverage was high and their cash level was low relative to their industry peers. They stated that this showed that these firms did not have enough financial slack to issue debt and that the market’s current valuation of the firm’s shares was such that a regular equity offering would transfer too much wealth away from existing shareholders. Their findings were in line with those of earlier studies by: Heinkel et al. (1986) and Eckbo et al. (1992) who modeled the choice between equity issues via rights offerings and regular offerings. Both models relied upon information asymmetry, and, consistent with the argument of Modigliani et al. (1958), predicted that managers who believed that their firm’s equity was undervalued preferred rights offerings to prevent wealth transfers from the firm’s existing shareholders.

They further found that, firms that sold equity in regular offerings did not have a dire need for equity financing in the pre-announcement year. Relative to industry peers, the cash levels of these firms were not particularly low and their debt ratios were not particularly high. In contrast, firms that filed shelf registrations, and especially firms that sold equity via rights offerings, had fairly low cash ratios and high debt ratios in the pre-announcement year. The pre-announcement performance varies greatly across the equity offering types. Firms that announce regular equity offerings exhibit superior performance relative to their industry peers in the pre-announcement year, especially if secondary shares are involved, while firms that announce shelf registrations exhibit normal performance and firms that announce rights offerings exhibit inferior performance (Heron et al., 2004).
2.4 Challenges Associated With Making Rights Issues

2.4.1 Determining An Appropriate Timing

Accurate determination of the timing of an offering is critical in measuring its price reactions, (Eckbo et al., 2007). Graham and Harvey (2001) found evidence that managers were concerned about the appropriate timing of equity issues. They time the issues around periods of temporary overvaluation. They further found that two-thirds of Chief Finance Officers (CFOs) who considered issuing common stock reported that the amount by which their stock was undervalued or overvalued was an important consideration.

Their findings were in line with those of Heron et al. (2004), who found that regular offerings were made by firms with temporarily high earnings that inflated market prices. Similarly, Eckbo et al. (2007) found that Chinese listed firms like firms in many countries, issued securities when there were opportunities to take advantage of market overvaluation. Consequently, rights issues could signal that a firm considers its current share price overvalued. In such instances they take advantage of the market to raise much needed capital.

Firms are more likely to issue equity when they expect a faster-growing economy, when they are going to increase their sales and investments in capital expenditure and research and development. When the economy booms, it is easier for firms to find investment opportunities and these investment opportunities are highly correlated with the growth of the overall economy. A firm’s stock price appreciation in the past year appears to be the most important determinant of equity reissuance decisions. Consequently, firms are more likely to conduct subsequent offerings within a shorter period of time when economic conditions are more favorable (Qian, 2011).

McLean et al. (2010) posit that market timing should be more feasible in less efficient stock markets. There is a good deal of empirical evidence suggesting that market timing plays a role in firms’ share issuance decisions. These include: Loughran and Ritter (1995), Spiess and Affleck-Graves (1995); Baker and Wurgler (2002), Daniel and Titman (2006), Pontiff and Woodgate (2008), and David, Pontiff, and Watanabe (2009). According to H. DeAngelo, L. DeAngelo and Stulz (2010), firms issue equity mainly because they do not have sufficient funding for investments without raising external capital. Consequently, the more a firm has specific growth opportunities, the higher the frequency of raising equity.
2.4.2 Higher Future Dividend Payout

Sukor et al. (2010) stated that with rights issues, firms commit themselves to large future dividend payments, which may not be feasible when the return from underlying investments is poor. They found this consistent with the findings of a much earlier study by Cai (1998), that attributed this to the poor performance of firms after issuance of rights issues. Based on 260 rights issues on the Tokyo Stock Exchange (TSE) between 1971 and 1986, Cai (1998), found that rights issuing firms performed poorly post issuance.

Various studies have argued that high dividend levels represent both a positive signal to investors of corporate health and a source of reductions in information asymmetry. These include; Asquith and Mullins (1983); Keane (1985); Fazzari, Hubbard and Petersen (1988). Contributing to this Burton et al. (2003), predicted that firms with low payout ratios may find it more difficult than firms with high payouts to persuade existing investors to increase their stake in the firm According to Hietala and Loyttyniemi (1991) and Bigelli (1998), in some European countries, a rights offer sometimes produces an increase in dividend yield. For example, if the rights offer does not affect the firm’s dollar dividend per share, and the rights offer subscription price is set at a discount from the pre-offer stock price, then the dividend as a percent of the post-offer share price increases as the share price falls due to the discounted sale of shares. Lukose et al. (2003), stated that in line with the findings of Bigelli (1998), there was positive market reaction at the announcement of most European rights issues, due to the quasi–split effect, which signals a large increase in dividends.

In a study on the determinants of dividend payout ratios in Ghana, Amidu and Abor (2006) stated that high dividend payout, reduced the funds available for investment. This was in turn associated with low future earnings growth. Duong et al. (2012) find their results consistent with those of Bigelli (1998) that positive abnormal announcement returns in Italian rights issues are accompanied by increases in dividend yield, which occur as long as the dividend is not reduced by a greater proportion than the proportion of reduction implied for the stock price by the subscription price discount.

2.4.3 Limited Investor Base

According to Barnes et al. (2006), private placings offer the potential to introduce new institutional shareholders to a firm’s register, and thus to expose the firm to increased external monitoring and the market for corporate control. Firms in poorer countries tend to
favour rights over other equity sale methods. This could be because the potential investor base is much smaller in poor countries, and existing shareholders therefore represent a relatively large fraction of the investor base (McLean et al., 2010).

Barnes et al. (2006) contend that rights issues leave little scope for ownership structure change, but a placing has the potential to alter ownership concentration significantly if the new issue is made to a small number of existing (institutional or block) shareholders. To the extent that such stakeholders are significant and possibly with board representation, they might be considered to be effectively inside owners, so that a placing by the firm has potential to increase insider ownership at the expense of minority shareholders. In consequence, ownership variables may drive the managerial choice of issue approach. They further found that for young firms without an established shareholder base, a successful issue by rights might not seem feasible. Young firms might also wish to develop institutional and block-holder relationships and may prefer to issue by firm private placement.

According to Burton et al. (2003), the degree of information asymmetry between owners and managers is generally considered to be negatively related to firm size, largely because of the poorer quality information and relative dearth of external analysis commonly associated with smaller firms' shares. Consequently, smaller firms may find it more difficult to persuade existing shareholders to increase their investments further via a rights issue. Based on this, they predicted a negative relationship between firm size and the propensity to use placings as opposed to rights issues.

### 2.4.4 High Cost Of Contacting Every Shareholder

To the extent that corporations choose among alternative financing methods so as to maximize the expected net proceeds of security offerings, floatation costs can have a large bearing on the choices an issuer makes. Floatation costs are made up of direct costs and indirect cost of selling a security through a public offering, where the direct costs include underwriter compensation, registration and listing fees, legal, accounting and printing expenses (Eckbo et al., 2007).

When comparing the costs of alternative floatation methods, one must control for firms’ self-selection of the issue method. For example, as Hansen and Pinkerton (1982) pointed out, it is possible that observed floatation costs of uninsured rights are particularly low because this method is selected when a large block holder is willing to guarantee subscription (which is
typically the case). It is also possible that firms tend to select uninsured rights more generally when shareholder concentration is high, and when stock return variance is low. This and other characteristics can reduce direct floatation costs regardless of the chosen floatation.

While debt offering floatation costs are low, debt issues have a finite life of generally less than 10 years duration. Thus, for a firm to have long term access to this debt capital, it is necessary to periodically refinance these debt issues, which involves repeated rounds of future floatation costs (Eckbo et al., 2007).

Barnes et al. (2006) contend that placings are typically negotiated privately among a small number of substantial investors, are much quicker to finalise and involve few of the lengthy and costly advertising and legal outlays, or extensive investor communication programmes characteristic of rights issues. The cost of issuing equity depends on the direct floatation costs as well as the wealth transfer costs from current shareholders to outside investors (Ginglinger et al., 2013).

According to Myers et al. (1984) and Eckbo et al. (1992), firms decide to issue equity when the net present value of investment exceeds the cost of issuing equity. Rights offerings are less viable for firms with that are widely held, since the merchandising costs involved are higher (Duong et al., 2012).

2.4.5 Negative Effects On Long Run Stock Performance

Since a rights issue is a portfolio of a public issue at the prevailing market price and a bonus issue, theoretically, a rights issue should have no effect on the price of the share (immediately after the announcement) in an informationally efficient capital market. Financial economists consider rights issue value-irrelevant information. However, even in a reasonably efficient market, the market’s reaction may be non-neutral if there is information asymmetry, or if the announcement of the rights issue signals the poor quality of the projects being accepted by the management (Agarwal et al., 2012).

When the rights issue is announced by a company, there may be a positive or a negative reaction to that announcement. Announcement effect captures that effect which is persistent in the market (Thenmozhi et al., 2007). Many researchers have tried to study the impact of rights issue announcement in different countries. Nelson (1965) using monthly data to examine 380 rights offerings in the United States for the period of 1946-1957, found no
announcement effects. He documented that there is no significant difference between share prices six months after rights offerings and six months prior to the rights offerings. Smith (1977), using monthly data, examined 38 rights offerings and 56 rights with standby underwriting offerings in the United States for the period of 1971-1975. He found no significant abnormal returns for either type during the month of the rights offerings. In line with these findings, Heron et al. (2004), found no significant change in operating performance after rights offerings announcements.

In contrast Ball, Brown and Finn (1977) examined 193 rights issues announced by firms listed on the Melbourne or Perth Stock Exchanges over the period of 1958-1970. They reported positive announcement period abnormal returns indicating that the share price reacts positively to announcements of the rights issues. They also concluded that the market is efficient with respect to the announcement of a rights issue, at least on a monthly basis. Similarly, Thenmozhi et al. (2007) found that the market reacts favorably to the announcement and the abnormal returns arising due to rights issue announcement are inversely related to firm size, market cumulative returns and variance of daily returns while there is a positive relationship with issue size. They concluded that rights offerings in India constitute favourable news and the information asymmetry theory is true as the market reacts favorably to the issue announcement.

Owen et al. (2008) investigated abnormal returns resulting from the announcement of a rights issue in Australia and found the underwriting cost to be significantly positively related to announcement returns, a result which is inconsistent with the theoretical model of Smith (1977) and the empirical evidence for United States public issues.

In contrast to the above findings, several studies have found that rights issues result in negative returns. Hou, Meyer and Auckland (2002) found that rights issues are associated with negative cumulative average abnormal returns. Their findings were similar to those of Eckbo et al. (1992) and Marsden (2000). In line with these Jensen (1986) stated that free cash flow theory predicts that announcement of equity offerings has a negative impact on stock prices. This is because the proportion of management ownership gets diluted and increases the resources available for any negative investment opportunities that managers may choose to undertake. Wu et al. (2002), found evidence from the Hong Kong market that rights issues
cause substantially negative announcement effects, whereas placements on average produce a positive average announcement. They suggested that it is the asymmetric information about control value that helps explain the adverse announcement effects of rights issues. They also found that the announcement of rights offering causes a larger drop in the stock prices of the issuer when the pre-issuance firm-specific market condition looks poorer, an unfavorable situation for new equity issues in general. They argued that changes in leverage signals management’s knowledge concerning expected changes in future firm performance. To lower the risk of financial distress, managers limit the firm’s debt obligation to what they expect the firm can meet with its future earnings. Therefore, when the proportion of debt in a firm’s capital structure after issuing new equity is reduced, management’s expectation of the firm’s future performance decreased, leading to a negative share price reaction.

Agarwal et al. (2012), observed a strong and positive relationship between increase in leverage and the abnormal returns. Rights issue, being an equity issue, decreases the leverage of the company. They found that rights issues that cause the lowest change in leverage bring about the maximum increase in stock returns. Further, they noted that markets may react negatively to rights issues because: The rights issue may signal the market about the poor quality of the project in which the management invests. This is because financing any new project with debt always has the disciplinary effect on the management of the company. Equity issue has no such disciplinary effect and a rights issue may signal the market about the poor quality of the projects in which the management is going to invest.

2.5 Measures That Can Be Taken To Enhance The Success Of Rights Issues

2.5.1 Underwriting Arrangements

An underwriter makes a commitment to buy the unsubscribed portion of shares at the subscription price less a take up fee. Underwriters also play an advisory role during rights issues. They advise the issuer on the security’s price, the size of the offering, desirable and undesirable rights characteristics as well as regulatory requirements to comply with. Consequently the use of underwriters effectively addresses the challenges associated with pricing and timing of rights issues (Eckbo et al., 2007). The presence of an underwriter also conveys the message that a stock is accurately valued. This in turn contributes to higher take up rates. Balachandran et al. (2009) found that fully underwritten rights issues are positively
correlated with expected shareholder take-up, while both partial standby and non underwritten issues have a negative correlation with take-up.

In non–underwritten rights issues (also called uninsured rights issues), the firm avoids paying underwriter fees by marketing the new shares through current shareholders, but the gross proceeds of the offering are not guaranteed. In rights with standby underwriting (also called standby rights offering), a standby underwriter guarantees the gross proceeds by agreeing to purchase and resell all shares not marketed through the rights method. Underwriters are useful in ensuring that any unsold portion of the rights is taken up by them.

In using the Black–Scholes Call Option Model (BSOPM) and building on the work of Smith (1977), a number of studies have examined the value of underwriting by merchant bankers. If a right is viewed as a call option on the firm’s stock, then the value of underwriting for an underwritten rights issue should equal a put option on the stock, (Sukor et al., 2010).

Most rights issues in international markets are underwritten. Owen et al. (2003) observed a similar trend in the Australian market. They further stated that earlier research showed that the demand for an underwriter is determined by expected stockholder participation, firm risk, issue size, trading frequency, and issue price discount. Their findings were that in the Australian market, use of underwriters was determined by: issue size, trading frequency, and market risk

Holderness et al. (2012) pointed out that one of the steps to ensure success of a rights offering is to have an investment bank underwrite. They further observed that the presence of an underwriter had a very strong association with the take up. Armitage (2002) predicted that the main purpose of underwriters is to guarantee the issue proceeds.

Balachandran et al. (2009) observed that companies in the Australian market could choose from among three different types of rights offerings: full standby (fully underwritten); uninsured (non-underwritten); and partial standby (“partly underwritten”). They found that the method chosen signaled the firm’s quality. High quality firms were found to choose fully underwritten offers while low quality firms chose partially underwritten ones.

2.5.2 Efficient Pricing

Bortolotti, Megginson and Smart (2008) defined under pricing as the percentage change in value experienced by investors that purchase shares at the offer price and hold until the
close of trading on the offer day. Bae and Levy (1994) studied the valuation of stock purchase rights as a call option using the rights valuation models suggested by Smith (1977) and by Galai and Schneller (1978). They examined a total of 177 rights issues traded on New York Stock Exchange (NYSE) and American Stock Exchange (AMEX) from January 1968 to December 1985. Their findings were that the rights valuation models, on average, overprice the rights. This implied that traded prices were lower than the theoretical prices. They argued that the possible volatility changes associated with raising capital through rights offerings accounted for some of the observed pricing deviation.

According to Breuer (2006), rights issues allow more freedom with respect to the determination of “optimal” issuance prices, because of the existence of tradable subscription rights. They drew from the work of Eckbo et al. (1992), who concluded that all factors constant, “good firms” prefer higher subscription prices than “bad” ones, because the danger of the offering failing due to too high a price, is smaller for “good” firms than it is for “bad” firms. The lower the issuance price, the greater the danger that the resulting equity price after the issuance (and the resolution of informational asymmetry) will violate investors’ reference prices, while the resulting utility loss cannot be completely offset by utility gains from higher prices of subscription rights.

Some researchers also argue that the subscription price is a signal of firm quality, and thus the discount usually offered in the price can be used to differentiate between issuing firms, assuming that firms do not engage in false signaling and that markets are efficient (Tan, Chng and Tong, 2002).

Poitrass (2002) studied the pricing efficiency of rights issues traded on the Stock Exchange of Singapore (SGX). He found his sample of 52 rights to trade at prices below their theoretical value. He attributed this to the short selling restrictions on SGX. He also found that the expected economic dilution associated with rights issues is only partially reflected in the ex rights stock prices. Therefore, the choice of the issuance price is a critical issue for firms.

Good firms can issue more new equity shares than bad ones can before violating reference prices for equity shares, hence there might be credible signaling possibilities for good firms. Companies have tended to shy away from deep discounted rights issues, that is, rights issues with low issuance prices (Breuer, 2006)
2.5.3 Analyzing The Shareholder Structure

According to Burton et al. (2003), firms with relatively high shareholder concentration and a significant number of large block holdings are more likely to use rights issues than are companies with more dispersed equity ownership patterns, because of the arguably lower levels of information asymmetry experienced by the former class of firm's typical shareholder and the relative ease involved with persuading existing shareholders to invest further in such companies.

They measured shareholder concentration by examining the proportion of a firm’s equity held as part of significant blockholdings. They defined significance as both 30% (i.e. the level at which takeover bids become mandatory under the provisions of the UK's City Code on Takeovers and Mergers), and 3% (the level at which shareholdings must be disclosed to the London Stock Exchange's authorities).

Kothare (1997) argued that in the US, firms characterised by concentrated ownership prefer issues by rights vis-à-vis public issues as they have relatively less potential to dilute existing ownership. They further noted that issue method choice has important effects on the ownership structure of US firms, ownership becoming more concentrated following rights issues but more diffuse following public issues, providing a strong rationale for the public issue method choice. In contrast, Barnes et al. (2006), argued that rights issues have relatively greater potential to reduce ownership concentration than public issues, which are more likely to increase effective insider ownership concentration.

Placing new issue shares with a recognised large investor that has acquired a reputation for investment performance itself may signal quality to the wider market, the benefits of the change in ownership concentration being likely to outweigh the adverse liquidity effect. Thus, the absence or presence of a significant external shareholder might have potential to explain issue method choice. Firms without such a significant investor may need to issue by rights, whereas firms that have a significant block-holder may be more likely to place new issues if this investor is instrumental in attracting further institutional support (Barnes et al., 2006).

Holderness et al. (2012) stated that a low participation rate could be seen as a sign that some, perhaps many, shareholders did not want management to raise equity. A low shareholder participation rate also results in wealth transfers among shareholders. Managers may be
reluctant to be publicly associated with both phenomena. Eckbo et al. (2007) observed that as firms grow, they tended to have less concentrated ownership structure. This could explain the decrease in rights issues by publicly traded U.S. industrial companies. In contrast to this trend; they found that there was widespread use of rights issues by firms in other countries that mainly have small and closely held firms.

2.6 Chapter Summary

The chapter has discussed the existing literature review on rights issues. The relevance of this to the topic of study has been analysed. Comparisons have also been drawn across existing literature. The next chapter looks at the methodology employed in collecting data, research design and data analysis.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
This chapter discusses the research methodology that was employed in conducting the study. Further, the research design and the population of the study are discussed. The selected sample is also discussed, as well as the techniques used in selecting the sample. The data collection and analysis methods employed are discussed. The chapter concludes by providing a summary

3.2 Research Design
The research design employed in this study was descriptive in nature. Blumberg, Cooper and Schindler (2008) defined a descriptive study as a study that attempts to find answers to the questions who, what, when, where and sometimes how. They further stated that descriptive studies are more formalized and are typically structured with clearly stated hypotheses or investigative questions. According to Ghauri (2005), the research design represents the overall strategy on gathering the information needed to answer the research problem under scrutiny. Since the goal of this study was to understand the use of rights issues in financing corporate activities, the choice of the descriptive approach was considered appropriate.

The study was guided four research objectives namely: to determine the factors that lead to the use of rights issues; to determine the factors that influence the success of rights issues; to determine the challenges that firms encounter when making rights issues; and to determine the measures that can be taken to enhance to use of rights issues as a means of raising funds to finance various corporate activities and plans.

3.3 Population and Sampling Design

3.3.1 Population
Blumberg et al. (2008) define a population as the total collection of elements about which we wish to make inferences. A population is also be defined as the complete set of cases or group members (Saunders, Lewis and Thornhill, 2003).

Data on rights issues made in Kenya was obtained from the Capital Markets Authority reports, (http://www.cma.or.ke) as well as from the corporate websites of some of the rights issuing firms. From the data so obtained, it was evident that there had been a good number of
rights issues made in the market. By their nature, rights issues are a secondary stock issue, hence issuers are public companies. The firms in the population were all listed on the Nairobi Securities Exchange.

The total number of rights issues between the year 2004 to December 2012 was 18. These were made by 11 firms, with some having made two or three different rights issues. Because of the relatively small number of issuing firms for the study period, it was considered necessary to study the entire population in order to draw reasonably accurate and representative conclusions to the study.

3.3.2 Sampling Design

3.3.2.1 Sampling Frame

According to Blumberg et al. (2008), the sampling frame is closely related to the population. They defined a sampling frame as the list of elements from which the sample is actually drawn. Saunders et al. (2003) noted that a sampling frame must consist of a complete and correct list of population members only. The latter defined a population as the complete set of cases or group members. In the study, the sampling frame was the firms that made rights issues in Kenya from 2004 to 2012, as well as the financial consultants that were involved in the rights issues. These were made by a total of 11 firms, with some having had multiple issues. The study therefore adopted a census approach, which is the collection and analysis of data from every possible case or group member in a population, according to Saunders et al. (2003).

3.3.2.2 Sampling Technique

Sampling techniques provide a range of methods that can be used to reduce the amount of data required by considering only data from a sub group, rather than the entire population (Saunders et al., 2003). Because of the small size of the population, the entire population was included in the study.

3.3.2.3 Sample Size

A sample is a segment of the population that is selected for investigation, and is a subset of the population (Ghauri, 2005). Sample selection refers to determining how many elements of the population should be included in the sample. For this study, the sample and the
population were the same. Consequently, data was collected from all the firms that had rights issues during the period of study.

3.4 Data Collection Methods
The study employed both primary and secondary data collection methods, to collect both qualitative and quantitative data. Saunders et al., 2003 state that secondary data is data used for a research project that was originally collected for some other purpose. Secondary data was obtained from the CMA website, the NSE website, academic journals, corporate websites of the rights issuing firms; Finance text books; and other relevant journals and published articles. The secondary data was collected through the use of a secondary data collection sheet. This tool was used to categorise the data by the source, the author(s); the title or subject; and how it addressed the four research objectives.

For purposes of collecting primary data, the researcher developed a questionnaire that was organized so as to address each of the four research objectives. The questionnaire was structured to improve the response time, as well as for easier coding and analysis of the data. It included mainly closed ended questions, as well as a few open ended questions. The closed ended questions utilized a five point Likert-type ranking from 1 to 5. There was no requirement to provide personal information, such as the respondent’s name, age or gender.

3.5 Research Procedure
The researcher began by designing a questionnaire for use in collecting primary data. The questionnaire was divided into five major sections covering the background information and each of the four research objectives. Each of the sections had several questions designed to gather sufficient and relevant information that would help in answering the research questions. To enhance the response rate and comply with some organizations’ policies on confidentiality, a cover letter explaining the reasons for data collection was provided. The mode of administration of the questionnaire was through either, drop and pick or scheduled physical interviews with the respondents. Interviews were scheduled by calling the respondents in advance to request for appointments. Where the respondents were not available for appointments they requested the researcher to drop the questionnaire and collect it at a later time.

For purposes of collecting secondary data, the researcher designed a secondary data collection sheet to guide the process. The document was then populated with data relating to
the various rights issues made. Some of the variables sought included: issue date; targeted funds; amount raised, subscription price and use of proceeds.

3.6 Data Analysis Methods
Once the secondary data and the primary data was collected it was checked for completeness and to detect errors that that could interfere with its accuracy. The data was then coded to facilitate input into an Excel worksheet, to facilitate analysis.

A research assistant was employed to assist in inputting the data into an excel worksheet. After data entry, a review was carried out to ensure that it was properly done before it was analysed through the use of SPSS. Using SPSS, the data was analysed using descriptive statistics and an output generated by the program. The descriptive statistics used included: frequencies, mean, and measures of dispersion such as; standard deviation and coefficient of variation.

Finally, the results of the data analysis were presented in the form of tables. The order of the questions in the questionnaire was also followed in presenting the results to facilitate flow of the paper. Qualitative data was also summarised, categorized, and presented in the form of tables.

3.7 Chapter Summary
This chapter describes the methodology employed in carrying out the study. The research design was descriptive in nature and was focused on rights issues made in Kenya. The sample size, the sampling technique and the questionnaire as the primary data collection instrument have all been described. The method used to collect secondary data has also been described. The chapter also discussed the methods used to analyse the data. The next chapter will present the findings of the study.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
The main focus of this chapter is to analyse, interpret and present the results of the research. The purpose of this study was to understand the use of rights issues as means to corporate financing. The study was guided by the following specific objectives: to determine the factors that influence the selection of rights issues in raising capital; to establish the factors that influence the success of rights issues; to determine the challenges that firms encounter when using rights issues; and to determine the measures that can be taken to enhance the use of rights issues in raising capital.

The study focused on organisations listed on the Nairobi Securities Exchange that made rights issues. The total number of rights issues was for the period of study was 18. Data was collected from a sample of 30 respondents representing all the organisations that made rights issues as well as investment bankers involved in rights issue transactions. A response rate of 93% was achieved. The research findings are presented in the form of tables and analysed by frequencies, mean, percentages, standard deviation and coefficient of variation.

The first section of this chapter comprises the general or background information collected such as the industry category of the organisation, number of years worked in the organisations and the designation of the respondents. The next section presents the information designed to respond to the research objectives as outlined in the study. This part had four sub sections each addressing a specific research objective.

4.2 General Information
The total number of rights issues made during the period of study and the issue characteristics is presented in the table that follows.
### Table 4.1 Rights Issues from 2004 to 2012

<table>
<thead>
<tr>
<th>Company</th>
<th>Shares issued(000)</th>
<th>Year</th>
<th>Issue Price</th>
<th>Sum raised(KShs billion)</th>
<th>Subscription Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCB</td>
<td>50,000</td>
<td>2004</td>
<td>49.00</td>
<td>2,750</td>
<td>112%</td>
</tr>
<tr>
<td>Uchumi</td>
<td>120,000</td>
<td>2005</td>
<td>10.00</td>
<td>1,270</td>
<td>106%</td>
</tr>
<tr>
<td>CFC Stanbic Bank</td>
<td>12,000</td>
<td>2005</td>
<td>62.00</td>
<td>744</td>
<td>100%</td>
</tr>
<tr>
<td>DTB</td>
<td>15,527</td>
<td>2006</td>
<td>50.00</td>
<td>2,306</td>
<td>297%</td>
</tr>
<tr>
<td>Olympia Capital</td>
<td>30,000</td>
<td>2007</td>
<td>14.00</td>
<td>428</td>
<td>102%</td>
</tr>
<tr>
<td>DTB</td>
<td>23,291</td>
<td>2007</td>
<td>70.00</td>
<td>2,902</td>
<td>178%</td>
</tr>
<tr>
<td>NIC Bank</td>
<td>16,483</td>
<td>2007</td>
<td>70.00</td>
<td>1,719</td>
<td>149%</td>
</tr>
<tr>
<td>HFCK</td>
<td>115,000</td>
<td>2008</td>
<td>20.00</td>
<td>2,369</td>
<td>103%</td>
</tr>
<tr>
<td>KCB</td>
<td>221,778</td>
<td>2008</td>
<td>25.00</td>
<td>8,122</td>
<td>146%</td>
</tr>
<tr>
<td>KCB</td>
<td>887,111</td>
<td>2010</td>
<td>17.00</td>
<td>12,500</td>
<td>83%</td>
</tr>
<tr>
<td>TPS Serena</td>
<td>24,702</td>
<td>2010</td>
<td>48.00</td>
<td>1,186</td>
<td>135%</td>
</tr>
<tr>
<td>Standard Chartered</td>
<td>15,109</td>
<td>2010</td>
<td>165.45</td>
<td>2,500</td>
<td>161%</td>
</tr>
<tr>
<td>KPLC</td>
<td>488,630</td>
<td>2010</td>
<td>19.50</td>
<td>9,830</td>
<td>103%</td>
</tr>
<tr>
<td>Kenya Airways</td>
<td>1,477,170</td>
<td>2012</td>
<td>14.00</td>
<td>14,488</td>
<td>70%</td>
</tr>
<tr>
<td>Diamond Trust Bank</td>
<td>24,456</td>
<td>2012</td>
<td>74.00</td>
<td>3,370</td>
<td>186%</td>
</tr>
<tr>
<td>NIC Bank</td>
<td>98,724</td>
<td>2012</td>
<td>21.00</td>
<td>7,007</td>
<td>338%</td>
</tr>
<tr>
<td>CFC Stanbic</td>
<td>121,637</td>
<td>2012</td>
<td>33.00</td>
<td>4,496</td>
<td>112%</td>
</tr>
<tr>
<td>Standard Chartered</td>
<td>22,080</td>
<td>2012</td>
<td>145.00</td>
<td>8,273</td>
<td>258%</td>
</tr>
</tbody>
</table>

Source: [http://www.cma.or.ke](http://www.cma.or.ke)

#### 4.2.1 Industry Category

The respondents were asked to indicate the industry category to which their respective organizations belonged. They had the option of indicating one of four categories, namely: Commercial and Services; Insurance or Investment; Energy and petroleum or Banking. The results are presented in Table 4.2. From the results, 33% of the respondents were from the banking industry; 27% from Insurance and Investment industry; 20% from Commercial and Services; 7% from Energy & Petroleum and 13% from the others category. This category comprised investment bankers involved in rights issues.
Table 4.2 Industry Category Of The Organisation

<table>
<thead>
<tr>
<th>Industry Category</th>
<th>Total</th>
<th>Senior Management</th>
<th>Middle Management</th>
<th>Finance Analyst</th>
<th>Consultant</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>30</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Insurance/Investment</td>
<td>27%</td>
<td>50%</td>
<td>26%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Commercial &amp; Services</td>
<td>20%</td>
<td>25%</td>
<td>16%</td>
<td>0%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>Energy &amp; Petroleum</td>
<td>7%</td>
<td>0%</td>
<td>11%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Others</td>
<td>13%</td>
<td>25%</td>
<td>5%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>0%</td>
<td>5%</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
</tr>
</tbody>
</table>

4.2.2 Respondent’s Designation

The study sought to establish the position of the respondent in the organization. Three levels were provided namely: senior management; middle management and non-managerial level. From Table 4.3, of the 30 respondents, a majority were middle management at 19, representing 63%. They were followed by senior management and consultants each having four 4 respondents (13% each). Finally, finance analysts and operations staff had a combined total of 10%.

Table 4.3 Designation Of Respondent

<table>
<thead>
<tr>
<th>Designation</th>
<th>Senior Management</th>
<th>Middle management</th>
<th>Finance Analyst</th>
<th>Consultant</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>30</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>100%</td>
<td>13%</td>
<td>63%</td>
<td>7%</td>
<td>3%</td>
</tr>
</tbody>
</table>
4.2.3 Period Respondent had worked in current organisation

The respondents were asked to indicate the number of years they had worked in their current organisation. It was expected that the longer the duration worked, the more conversant the respondents would be with the operations of the organisation and more specifically rights issues made by the organisation. The results were as summarized in Table 4.4. From the table below, 40% of the respondents had worked for their organization for more than 5 years; 33% for 4-5 years; 17% had worked for their organisation for 2-3 years and finally only 10% had worked for less than 1 year.

Table 4.4 Period the respondent had worked in the organisation

<table>
<thead>
<tr>
<th>Number of years worked</th>
<th>Over 5 years</th>
<th>4-5 years</th>
<th>2-3 years</th>
<th>Up to 1 year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Respondents</td>
<td>12</td>
<td>10</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Percentage</td>
<td>40%</td>
<td>33%</td>
<td>17%</td>
<td>10%</td>
</tr>
</tbody>
</table>

The responses were further analysed by the designation of the respondents. Table 4.5 summarises the responses. Of the respondents who were senior management, 75% had worked for their organisation for over 5 years while 25% had worked for 2-3 years. Out of the respondents who were middle management, 42% had worked for over 5 years, 32% had worked for 4-5 years; 11% had worked for 2-3 years and 16% had worked for less than 1 year. The other respondents were finance analysts, consultants and operations. For the finance analysts, none had worked for over 5 years or for less than 1 year. They had worked for 4-5 years and 2-3 years in equal proportion, 50%. The consultants had 25% having worked for over 5 years while the balance had worked for 4-5 years. There was one respondent from operations who had worked for 2-3 years.

Table 4.5 Period the respondent had worked in the organisation – by Designation

<table>
<thead>
<tr>
<th>Designation</th>
<th>Senior Management</th>
<th>Middle management</th>
<th>Finance Analyst</th>
<th>Consultant</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Over 5 years</td>
<td>75%</td>
<td>42%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>4-5 years</td>
<td>0%</td>
<td>32%</td>
<td>50%</td>
<td>75%</td>
<td>0%</td>
</tr>
</tbody>
</table>
**4.3 Factors that lead to the selection of rights issues**

When organisations seek to raise funds, they analyse various options available to them, before finally narrowing down their choice. The respondents were asked to list the various sources of funds used. The responses included: equity, bonds, loans, commercial paper, term notes, deposits and preference shares.

The study sought to find out what benefits rights issues presented that led organisations to use them. The respondents were asked to indicate on a Likert scale the extent to which they considered a list of factors relevant in the choice. The results obtained for the various factors are summarised in Table 4.6. From the results the existence of a favorable regulatory environment ranked the most significant factor in influencing the use of rights issues. That rights issues are fairly certain ranked second; high stock prices ranked third, lower floatation costs ranked fourth, while the factor ranked as the least significant was preservation of ownership and control.

**Table 4.6 Factors that lead to the selection of rights issues**

<table>
<thead>
<tr>
<th>Factors that lead to the selection of rights issues</th>
<th>Respondents</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Coefficient of variation</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relatively lower floatation Cost</td>
<td>26</td>
<td>3.54</td>
<td>1.24</td>
<td>0.35</td>
<td>4</td>
</tr>
<tr>
<td>Preservation of ownership and control</td>
<td>29</td>
<td>3.45</td>
<td>1.35</td>
<td>0.39</td>
<td>5</td>
</tr>
<tr>
<td>They are fairly certain</td>
<td>28</td>
<td>3.86</td>
<td>1.11</td>
<td>0.29</td>
<td>2</td>
</tr>
<tr>
<td>High stock prices</td>
<td>29</td>
<td>3.67</td>
<td>1.17</td>
<td>0.32</td>
<td>3</td>
</tr>
<tr>
<td>Favorable regulatory environment</td>
<td>28</td>
<td>3.93</td>
<td>1.05</td>
<td>0.26</td>
<td>1</td>
</tr>
</tbody>
</table>

A discussion of the results for the specific factors follows.

**4.3.1 Extent to which low floatation costs influenced the selection of rights issues**

The respondents were asked to indicate the extent to which they considered that relatively lower floatation costs led to the use of rights issues. The results are presented in Table 4.7. From the responses received, 27% of the respondents rated floatation costs at very large
extent; 31% at large extent; 23% at small extent; 15% at some extent, while 4% felt that floatation costs had no effect on selection of rights issues.

**Table 4.7 Extent to which low floatation costs influenced the selection of rights issues**

<table>
<thead>
<tr>
<th>Extent to Which Floatation Costs Influenced</th>
<th>Respondents</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Large Extent</td>
<td>7</td>
<td>27%</td>
</tr>
<tr>
<td>Large Extent</td>
<td>8</td>
<td>31%</td>
</tr>
<tr>
<td>Small Extent</td>
<td>6</td>
<td>23%</td>
</tr>
<tr>
<td>Some Extent</td>
<td>4</td>
<td>15%</td>
</tr>
<tr>
<td>Not at all</td>
<td>1</td>
<td>4%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>26</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

**4.3.2 Extent to which preservation of ownership and control influenced the selection of rights issue**

One of the arguments usually put forth in support of rights issues is that they do not lead to dilution of ownership and control. The respondents were asked to indicate the extent to which the need to preserve ownership and control important in choosing rights issues. The responses are summarised in Table 4.8. From the results, 34% of the respondents indicated that the influence was to a large extent; 24% indicated that it was to a very large extent; 17% indicated that it was to some extent; 10% indicated that it was to some extent, while 14% indicated that the need to preserve ownership and control had no effect on the selection of rights issues.

**Table 4.8 Extent to which preservation of ownership and control influenced to selection of rights issue**

<table>
<thead>
<tr>
<th>Extent to Which Preservation of Ownership and Control Influenced</th>
<th>Respondents</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Large Extent</td>
<td>7</td>
<td>24%</td>
</tr>
<tr>
<td>Large Extent</td>
<td>10</td>
<td>34%</td>
</tr>
<tr>
<td>Some Extent</td>
<td>5</td>
<td>17%</td>
</tr>
<tr>
<td>Small Extent</td>
<td>3</td>
<td>10%</td>
</tr>
<tr>
<td>Not at all</td>
<td>4</td>
<td>14%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>29</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>
4.3.3 Extent to which high level of certainty influenced the selection of rights issues

Rights issues are perceived to be a relatively certain way of raising finance. The respondents were asked to indicate on a scale the extent to which they considered this the case. Out of the 29 responses to this question, 4 were senior management; 17 were middle level management; 2 were finance analysts; 4 were consultants while 1 was in operations.

Senior management rated the certainty level highly, with 50% score for both large extent and very large extent. According to middle management the extent of the influence of the level of certainty was rated as very large by 24% and large by 59% of the respondents. A total of 18% of middle level management rated the influence of the level of certainty as an influence at to some extent (6%), to a small extent (6%) and not at all (6%).

Of the respondents who were finance analysts, that a high level of certainty is important to a very large extent was rated at 50% and 50% for to some extent. The consultants’ category rated its importance at 25% for each of the four variables rated. The respondent from operations considered that high level of certainty was only relevant to some extent. These results are presented in Table 4.9 below.

Table 4.9 Extent to which high level of certainty influenced the selection of rights issues

<table>
<thead>
<tr>
<th>Designation</th>
<th>Senior management</th>
<th>Middle management</th>
<th>Finance analyst</th>
<th>Consultants</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>4</td>
<td>17</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Very Large Extent</td>
<td>50%</td>
<td>24%</td>
<td>50%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Large Extent</td>
<td>50%</td>
<td>59%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Some Extent</td>
<td>0%</td>
<td>6%</td>
<td>50%</td>
<td>25%</td>
<td>100%</td>
</tr>
<tr>
<td>Not at all</td>
<td>0%</td>
<td>6%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Small Extent</td>
<td>0%</td>
<td>6%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.3.4 Extent to which high stock prices influenced the selection of rights issues

Some past research on rights issues has found that firms make rights issues to take advantage of temporarily high stock prices. The respondents were asked to indicate the extent to which they considered this to be the case. From the responses received as presented in Table 4.10, 50% of senior management indicated that this was true to a very large extent, 25% indicated
that this was to a large extent and 25% that it was to some extent. None of the senior management rated the extent of influence as not at all.

Of the middle management, 22% stated that the influence of high stock prices was to a very large extent; 33% stated that it was to a large extent; 28% felt that it was to some extent, 17% to a small extent, while none stated that it had no influence at all.

For the other designations, the rating for very large extent of influence was 50% by both finance analysts and consultants; the rating for large extent was 25% by consultants and 0% by finance analyst and operations; a rating of some extent was 50% by finance analysts and 0% by consultants and operations; and finally only consultants had a rating of not at all of 25%.

Overall, the rating of the influence of high stock prices was: very large extent (31); large extent (28%); to some extent (24%); to a small extent (14%) and 3% for not at all.

Table 4.10 Extent to which high stock prices influenced the selection of rights issues

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Senior Management</th>
<th>Middle Management</th>
<th>Finance Analyst</th>
<th>Consultant</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Large Extent</td>
<td>29</td>
<td>4</td>
<td>18</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Large Extent</td>
<td>28%</td>
<td>50%</td>
<td>22%</td>
<td>50%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>Some Extent</td>
<td>24%</td>
<td>25%</td>
<td>33%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Small Extent</td>
<td>14%</td>
<td>0%</td>
<td>17%</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Not at all</td>
<td>3%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.3.5 Extent to which favorable regulatory requirements influenced the selection of rights issues

The status of the regulatory framework within which organisations operate could have an influence on the type of financing used. The study sought to investigate the extent to which the respondents considered that this affected the use of rights issues. The results are presented in Table 4.11. Of the 28 respondents to this question, 32% stated that a favourable regulatory environment affected rights issues to a very large extent: 43% stated that the effect was to a large extent; 14% to some extent; 7% to a small extent, while 4% stated that the regulatory environment had no effect at all on the selection of rights issues. All the sectors except Insurance and Investment rated the level of influence of the regulatory environment highly, with ratings of 63% to 100% for very large extent, large extent and some extent.
Table 4. 11 Extent to which favorable regulatory requirements influenced the selection of rights issues

<table>
<thead>
<tr>
<th>Extent</th>
<th>Commercial &amp; Services</th>
<th>Insurance/Investment</th>
<th>Energy &amp; Petroleum</th>
<th>Banking</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Large Extent</td>
<td>28</td>
<td>5</td>
<td>8</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td>Large Extent</td>
<td>32%</td>
<td>60%</td>
<td>25%</td>
<td>0%</td>
<td>30%</td>
</tr>
<tr>
<td>Some Extent</td>
<td>43%</td>
<td>20%</td>
<td>25%</td>
<td>100%</td>
<td>60%</td>
</tr>
<tr>
<td>Small Extent</td>
<td>14%</td>
<td>20%</td>
<td>13%</td>
<td>0%</td>
<td>10%</td>
</tr>
<tr>
<td>Not at all</td>
<td>7%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.4 Factors That Influence The Success of Rights Issues

There are various factors that influence the outcome of rights issues, making them either successful or unsuccessful. The second objective of the study was to establish the extent to which various factors influenced the outcome of rights issues.

From the results presented in Table 4.12, the most significant factor in influencing the outcome of rights issues was shareholder takeup. This was followed closely by the firm’s performance and stock market trend, ranked 2 and 3 respectively. The purpose for which funds are raised was ranked 4, subscription price ranked 5, and ownership structure and presence of underwriting ranked 6 and 7 respectively. From the results, the presence of underwriting was the least significant factor in the influencing the outcome of rights issues.

Table 4. 12 Factors that influence the success of rights issues

<table>
<thead>
<tr>
<th></th>
<th>Respondents</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Coefficient of variation</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>The subscription price</td>
<td>30</td>
<td>4.40</td>
<td>0.89</td>
<td>0.20</td>
<td>5</td>
</tr>
<tr>
<td>Shareholder take up</td>
<td>30</td>
<td>4.53</td>
<td>0.68</td>
<td>0.15</td>
<td>1</td>
</tr>
<tr>
<td>Ownership structure</td>
<td>30</td>
<td>3.93</td>
<td>0.91</td>
<td>0.23</td>
<td>6</td>
</tr>
<tr>
<td>Current trend of the stock market</td>
<td>30</td>
<td>4.33</td>
<td>0.76</td>
<td>0.17</td>
<td>3</td>
</tr>
<tr>
<td>Presence of underwriting</td>
<td>30</td>
<td>3.50</td>
<td>1.07</td>
<td>0.30</td>
<td>7</td>
</tr>
<tr>
<td>Purpose for which funds are raised</td>
<td>30</td>
<td>4.20</td>
<td>0.76</td>
<td>0.18</td>
<td>4</td>
</tr>
<tr>
<td>The firm’s performance</td>
<td>30</td>
<td>4.40</td>
<td>0.67</td>
<td>0.15</td>
<td>2</td>
</tr>
</tbody>
</table>
A discussion of the rating by various respondents of the specific factors discussed above follows.

4.4.1 Importance Of The Subscription Price In Determining The Outcome Of Rights Issues

The price at which rights are sold has an influence on the outcome of rights issues. The respondents were asked to state the extent to which the subscription price influenced the outcome of rights issues. From the results obtained as presented in Table 4.13, 57% of the respondents stated that the price was very important; 33% stated that it was important; 7% stated that it was somewhat important, while only 3% stated that it did not in any way affect the outcome of rights issues. From the results the respondents generally considered the subscription price to have a high level of influence on the outcome of rights issues. For each of the industries the combined rating for very important and important was quite high at:100%(Commercial & services);63%(Insurance & investment);100%(Energy & petroleum);100%(banking and the others category. Only 10% of the respondents considered that the subscription was either not relevant (3%) or only relevant to a small extent (7%).

Table 4. 13 Importance of the subscription price in determining the outcome of rights issues

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Commercial &amp; Services</th>
<th>Insurance or Investment</th>
<th>Energy &amp; Petroleum</th>
<th>Banking</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Important</td>
<td>30</td>
<td>6</td>
<td>8</td>
<td>2</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Important</td>
<td>57%</td>
<td>67%</td>
<td>38%</td>
<td>50%</td>
<td>90%</td>
<td>0%</td>
</tr>
<tr>
<td>Some what important</td>
<td>33%</td>
<td>33%</td>
<td>25%</td>
<td>50%</td>
<td>10%</td>
<td>100%</td>
</tr>
<tr>
<td>Not at all</td>
<td>7%</td>
<td>0%</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.4.2 Importance Of The Degree Of Ownership Concentration In Determining The Outcome Of Rights Issues

The results of the perceived influence of the ownership concentration of an organisation on the outcome of rights issues, is presented in Table 4.14. From the results, 30% of the respondents considered that ownership concentration was very important; 40% considered that it was important; 23% considered that it was somewhat important; and 7% considered
that it was least important. Further analysis reveals that a majority of the respondents from the various sectors considered the degree of ownership concentration to be either very important or important. This illustrated by the combined rating of these two categories at 83 % (commercial/services); 63 % (Insurance/investment); 50 % (energy/petroleum); 70 % (banking)) and 100 % (others).

Table 4.14 Importance of the degree of ownership concentration in determining the outcome of rights issues

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Commercial &amp; Services</th>
<th>Insurance/Investment</th>
<th>Energy &amp; Petroleum</th>
<th>Banking</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Important</td>
<td>30%</td>
<td>6%</td>
<td>25%</td>
<td>2%</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td>Important</td>
<td>40%</td>
<td>50%</td>
<td>38%</td>
<td>50%</td>
<td>30%</td>
<td>50%</td>
</tr>
<tr>
<td>Some what important</td>
<td>23%</td>
<td>17%</td>
<td>38%</td>
<td>0%</td>
<td>20%</td>
<td>0%</td>
</tr>
<tr>
<td>Least Important</td>
<td>7%</td>
<td>0%</td>
<td>0%</td>
<td>50%</td>
<td>10%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.4.3 Importance Of Underwriting In Determining The Outcome Of Rights Issues

Rights issues may or may not be underwritten. The study sought to investigate the impact of underwriting on the outcome of rights issues. The results are presented in the table 4.15. Only 30% considered underwriting very important; 50% of the respondents considered that underwriting important; 20% stated that underwriting was least important and 13% stated that it was somewhat important.3% of the respondents stated that underwriting was not at all important in influencing the outcome of rights issues.

Except for some respondents in the insurance/investment category, none of the respondents considered that the presence of underwriting had completely no effect on the outcome of rights issues.13% of the respondents in this category did not think that underwriting in any way affected the outcome of issues. The others category had the highest rating for important, at 100% followed by insurance/investment (63%), commercial & services (50%) and energy & petroleum (50%).
Table 4.15 Importance of underwriting in determining the outcome of rights issues

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Commercial &amp; Services</th>
<th>Insurance or Investment</th>
<th>Energy &amp; Petroleum</th>
<th>Banking</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Important</td>
<td>30</td>
<td>6</td>
<td>8</td>
<td>2</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Important</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Least Important</td>
<td>20%</td>
<td>0%</td>
<td>63%</td>
<td>50%</td>
<td>40%</td>
<td>100%</td>
</tr>
<tr>
<td>Somewhat important</td>
<td>13%</td>
<td>33%</td>
<td>0%</td>
<td>0%</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>Not at all important</td>
<td>3%</td>
<td>0%</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.4.4 Importance Of Trend And Tone Of The Stock Market In Determining The Outcome Of Rights Issues

The condition of the stock and capital markets could influence the use of rights issues by organisations. Therefore organisations would normally assess the market when making financing decisions. The respondents were asked to indicate the extent to which they considered the market condition important in influencing the decision to make rights issues. The results are presented in Table 4.16. From the results a total of 90% of the respondents stated that the market condition was either very important or important. 47% stated that it was very important, while 43% stated that it was important. The respondents, who stated that the market condition was not of much importance, comprised 10% of the respondents. There was a general high rating of the variable as evidenced by the rating of 100% by the others and energy categories for both important and very important. The least combined rating was 83% by the commercial and services category.

Table 4.16 Importance of trend and tone of the stock market in determining the outcome of rights issues

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Commercial &amp; Services</th>
<th>Insurance or Investment</th>
<th>Energy &amp; Petroleum</th>
<th>Banking</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Important</td>
<td>30</td>
<td>6</td>
<td>8</td>
<td>2</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Important</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Least Important</td>
<td>20%</td>
<td>0%</td>
<td>63%</td>
<td>50%</td>
<td>40%</td>
<td>100%</td>
</tr>
<tr>
<td>Somewhat important</td>
<td>13%</td>
<td>33%</td>
<td>0%</td>
<td>0%</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>Not at all important</td>
<td>3%</td>
<td>0%</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>
4.4.5 Importance Of Shareholder Take Up In Determining The Outcome Of Rights Issues

Table 4.17 provides a summary of the results of the impact of shareholder take up on the outcome of rights issues. Of the 30 respondents, 18 stated that shareholder take up has a very important influence on the outcome of rights issues. This represents 60% of the population. Another 11 respondents, representing 37% of the population considered that shareholder take up is important in determining the success of rights issues. Only 3% of the respondents indicated that take up was of least importance.

From the results, the respondents generally felt that shareholder take up significantly affects the outcome of rights issues. This is illustrated by the high frequency ranging from 88% to 100% for the ranking of very important and important.

Table 4.17 Importance of Shareholder take up in determining the outcome of rights issues

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Commercial &amp; Services</th>
<th>Insurance or Investment</th>
<th>Energy &amp; Petroleum</th>
<th>Banking</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Important</td>
<td>60%</td>
<td>50%</td>
<td>38%</td>
<td>0%</td>
<td>90%</td>
<td>100%</td>
</tr>
<tr>
<td>Important</td>
<td>37%</td>
<td>50%</td>
<td>50%</td>
<td>100%</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>Least Important</td>
<td>3%</td>
<td>0%</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.4.6 Importance Of The Purpose Of Funds In Determining The Outcome Of Rights Issues

It is common practice for organisations seeking to make rights issues to disclose the intended use of the proceeds. This is important to enable shareholders to make an informed decision guided by their views about use of proceeds. The study sought to find out the extent to which the disclosed intended use of rights issue proceeds determines the outcome. Results from Table 4.18 indicate that 50% of the respondents consider the intended use of proceeds important; 37% consider it very important; 10% consider it somewhat important and 3% consider it least important.

Further analysis reveals that for all the sectors, the rating for the purpose for which funds are raised was quite high. Three sectors namely: energy & petroleum, banking and the others category had a total rating of 100% for the very important and important categories.
Table 4.18 Importance of the purpose of funds in determining the outcome of rights issues

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Commercial &amp; Services</th>
<th>Insurance or Investment</th>
<th>Energy &amp; Petroleum</th>
<th>Banking</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Important</td>
<td>30</td>
<td>6</td>
<td>8</td>
<td>2</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Very Important</td>
<td>50%</td>
<td>50%</td>
<td>38%</td>
<td>100%</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Some what important</td>
<td>37%</td>
<td>33%</td>
<td>38%</td>
<td>0%</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Least Important</td>
<td>10%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.4.7 Importance Of The Firm’s Performance In Determining The Outcome Of Rights Issues

The performance of rights issuing firms may encourage or discourage investors from participating in rights issues. Investors are more likely to buy the rights that have a record of good performance or good future prospects. The results of the study as summarised in table 4.19 reveal that the respondents consider a firm’s performance to have a significant influence on rights issues. 50% of the respondents stated that this variable was very important; 40% stated that it was important and 10% stated that it was somewhat important. None of the respondents considered it unimportant. Closer scrutiny reveals that 83% of the respondents from the commercial and services sector rated it as very important; and 17% as important.

Table 4.19 Importance of the firm’s performance in determining the outcome of rights issues

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Commercial &amp; Services</th>
<th>Insurance or Investment</th>
<th>Energy &amp; Petroleum</th>
<th>Banking</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Important</td>
<td>50%</td>
<td>83%</td>
<td>38%</td>
<td>0%</td>
<td>60%</td>
<td>50%</td>
</tr>
<tr>
<td>Important</td>
<td>40%</td>
<td>17%</td>
<td>38%</td>
<td>100%</td>
<td>40%</td>
<td>0%</td>
</tr>
<tr>
<td>Some what important</td>
<td>10%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
<td>0%</td>
<td>50%</td>
</tr>
</tbody>
</table>

In addition to the variables discussed above, the respondents also listed other variables they considered important in influencing rights issues. These included: the economic or political nature of the company; shareholder expectations; share liquidity or free float; engagement of their parties for brokerage and management of shares; public awareness of the issues through
marketing efforts; actions of similar organisations at the time of the issue and prevailing market conditions, such as high interest rates.

4.5 Challenges Encountered When Making Rights Issues
As with other methods of raising capital and more specifically equity, there are certain hurdles that organisations encounter, when making rights issues. The study sought to determine the major challenges that organizations encountered when raising funds through the use of rights issues. To determine this, the respondents were asked to indicate the extent to which they had encountered a list of challenges. The results are summarised in table 4.20. Timing had the highest mean, the lowest coefficient of variation, and ranked first as a challenge of rights issues. Limited investor base was ranked second; higher future dividend payment was ranked third, negative stock price effects was ranked fourth, while high cost of contacting shareholders was ranked fifth. From the above, timing was the most important challenge, while the cost of contacting shareholders was the least important.

Table 4.20 Challenges encountered when making rights issues

<table>
<thead>
<tr>
<th>Challenges</th>
<th>No.</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Coefficient of variation</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determining an appropriate timing</td>
<td>30</td>
<td>4.20</td>
<td>0.81</td>
<td>0.19</td>
<td>1</td>
</tr>
<tr>
<td>Limited investor base</td>
<td>29</td>
<td>3.69</td>
<td>0.81</td>
<td>0.22</td>
<td>2</td>
</tr>
<tr>
<td>Higher future dividend payment</td>
<td>30</td>
<td>3.40</td>
<td>0.97</td>
<td>0.28</td>
<td>3</td>
</tr>
<tr>
<td>Negative stock price effects</td>
<td>30</td>
<td>3.43</td>
<td>1.14</td>
<td>0.33</td>
<td>4</td>
</tr>
<tr>
<td>High cost of contacting shareholders</td>
<td>30</td>
<td>2.87</td>
<td>1.20</td>
<td>0.42</td>
<td>5</td>
</tr>
</tbody>
</table>

4.5.1 Determining An Appropriate Timing
The timing of rights issues should be carefully thought out to improve the chances of its success. Table 4.21 summarises the results of the study. The extent to which the respondents considered timing a challenge was 43% for large extent; 40% for very large extent; 13% for some extent and 3 5 for small extent. Of the respondents from senior management, 50% thought that timing was a challenge to a large extent, 25% for a very large extent and 25% to some extent. Of the middle management respondents, 37% thought timing was a challenge to a large extent; 42% to a very large extent and 21% for the balance. Both the finance analysts and the consultants rated the importance of timing at 100% for important and very important, while operations rated it as important to a large extent.
Table 4.21 Determining an appropriate timing

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Senior Management</th>
<th>Middle level management</th>
<th>Finance analyst</th>
<th>Consultants</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>30</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td><strong>Very Large Extent</strong></td>
<td>40%</td>
<td>25%</td>
<td>42%</td>
<td>50%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Large Extent</strong></td>
<td>43%</td>
<td>50%</td>
<td>37%</td>
<td>50%</td>
<td>50%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Some Extent</strong></td>
<td>13%</td>
<td>25%</td>
<td>16%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Small Extent</strong></td>
<td>3%</td>
<td>0%</td>
<td>5%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.5.2 Higher Future Dividend Payout

The study sought the respondents’ views on whether higher future dividend payments following rights issues was considered a significant challenge. From the results presented in table 4.22, 13% of them thought it quite a significant challenge. 33% to a large extent; 33% to some extent and 20% to a small extent. The category of respondents who considered this relevant to a very large extent was middle management at 21%; while all the other categories had 0% rating. Overall the results reveal that the respondents did not perceive the issues of higher dividend payment to be a significant challenge for rights issuers.

Table 4.22 Higher future dividend payout

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Senior Management</th>
<th>Middle level management</th>
<th>Finance analyst</th>
<th>Consultants</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>30</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td><strong>Very Large Extent</strong></td>
<td>13%</td>
<td>0%</td>
<td>21%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Large Extent</strong></td>
<td>33%</td>
<td>25%</td>
<td>42%</td>
<td>50%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Some Extent</strong></td>
<td>33%</td>
<td>50%</td>
<td>32%</td>
<td>0%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Small Extent</strong></td>
<td>20%</td>
<td>25%</td>
<td>5%</td>
<td>50%</td>
<td>50%</td>
<td>100%</td>
</tr>
</tbody>
</table>

4.5.3 Limited Investor Base

The results are presented in table 4.23.41% of the respondents stated that limited investor base was a challenge to some extent; 38% to a large extent; 17% to a very large extent and 3% to a small extent. In terms of the designation of the respondents senior management thought that it was only a challenge to a small extent, while the other designations considered it a significant challenge. For instance, finance analysts and operations rated limited investor
base as a significant challenge to a large and very large extents with combined frequencies of 100% for each designation.

**Table 4.23 Limited investor base**

<table>
<thead>
<tr>
<th>Designation</th>
<th>Total</th>
<th>Senior Management</th>
<th>Middle management</th>
<th>Finance analyst</th>
<th>Consultants</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>29</td>
<td>4</td>
<td>18</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Very Large Extent</td>
<td>17%</td>
<td>25%</td>
<td>11%</td>
<td>50%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Large Extent</td>
<td>38%</td>
<td>50%</td>
<td>33%</td>
<td>50%</td>
<td>25%</td>
<td>100%</td>
</tr>
<tr>
<td>Some Extent</td>
<td>41%</td>
<td>0%</td>
<td>56%</td>
<td>0%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>Small Extent</td>
<td>3%</td>
<td>25%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

**4.5.4 High Cost of Contacting Each Shareholder**

From the results in table 4.24, senior management stated that the cost of contacting shareholders was largely not relevant. 50% found it relevant to a small extent; 25% to some extent and 25% not relevant at all. Of the middle level management, 42% found the cost relevant to a small extent; 21% to a large extent, 16% to some extent; 16% to a large extent and 5% not at all relevant. 50% of the finance analysts found it relevant to a large extent, while 50% thought it was irrelevant. Of the consultants, 25% found it relevant to a small extent; 50% to a large extent and 25% to a small extent. Finally operations thought it was relevant to some extent. Overall results show that 10% considered the cost relevant to a large extent, 23% to a large extent; 20% to some extent; 37% to a small extent and 10% not at all relevant.

**Table 4.24 High cost of contacting each shareholder**

<table>
<thead>
<tr>
<th>Designation</th>
<th>Total</th>
<th>Senior Management</th>
<th>Middle level management</th>
<th>Finance analyst</th>
<th>Consultants</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Small Extent</td>
<td>37%</td>
<td>50%</td>
<td>42%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Large Extent</td>
<td>23%</td>
<td>0%</td>
<td>21%</td>
<td>50%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>Some Extent</td>
<td>20%</td>
<td>25%</td>
<td>16%</td>
<td>0%</td>
<td>25%</td>
<td>100%</td>
</tr>
<tr>
<td>Not at all</td>
<td>10%</td>
<td>25%</td>
<td>5%</td>
<td>50%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Very Large Extent</td>
<td>10%</td>
<td>0%</td>
<td>16%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>
4.5.5 Negative Effects On Long Run Stock Performance

Some researchers have suggested that rights issues results in lower stock prices in the long run. The study sought the respondents’ views on the extent to which they perceived this to be the case. From the results obtained as presented in table 4.25, 23% of the respondents thought this to be true to a very large extent; 20% to a large extent; 37% to some extent; 17% to a small extent and 3% considered it not at all true.

Table 4.25 Negative effects on long run stock performance

<table>
<thead>
<tr>
<th>Designation</th>
<th>Total</th>
<th>Senior Management</th>
<th>Middle level management</th>
<th>Finance analyst</th>
<th>Consultants</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Very Large Extent</td>
<td>23%</td>
<td>25%</td>
<td>16%</td>
<td>50%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>Large Extent</td>
<td>20%</td>
<td>25%</td>
<td>21%</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Some Extent</td>
<td>37%</td>
<td>50%</td>
<td>32%</td>
<td>50%</td>
<td>25%</td>
<td>100%</td>
</tr>
<tr>
<td>Small Extent</td>
<td>17%</td>
<td>0%</td>
<td>26%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Not at all</td>
<td>3%</td>
<td>0%</td>
<td>5%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

The respondents also provided other challenges they considered relevant. These included: over-subscription; political or economic instability and the level of shareholder education.

4.6 Measures That Can Be Taken To Enhance The Success Of Rights Issues

Rights issues can be very useful for firms that need to raise funds to finance their growth or expansion plans. Their use conveys certain advantages such as the high level of certainty, the relatively lower cost of capital, preservation of ownership and low floatation costs. For this reason their use should be enhanced to make them a more accessible form of financing.

The study sought to determine the measures that can be taken to improve the success of rights issues. The respondents were asked to indicate the level of importance they attached to a list of factors in determining the outcome of rights issues. From table 4.26, efficient pricing was the most important factor in determining the outcome of issues. It had a mean of 4.50 and a coefficient of variation of 0.1913. Analysing the shareholder structure ranked second and finally underwriting arrangements ranked third.
Table 4.26 Measures to enhance the success of rights issues

<table>
<thead>
<tr>
<th>Measure</th>
<th>No.</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Coefficient of variation</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underwriting arrangements</td>
<td>30</td>
<td>3.63</td>
<td>1.19</td>
<td>0.33</td>
<td>3</td>
</tr>
<tr>
<td>Efficient pricing</td>
<td>30</td>
<td>4.50</td>
<td>0.86</td>
<td>0.19</td>
<td>1</td>
</tr>
<tr>
<td>Analyzing the shareholder structure</td>
<td>30</td>
<td>4.10</td>
<td>0.92</td>
<td>0.23</td>
<td>2</td>
</tr>
</tbody>
</table>

4.6.1 Underwriting Arrangements

The respondents were asked to indicate how important they considered underwriting in enhancing the outcome of rights issues. From the results in Table 4.27, 50% senior management considered underwriting very important; 25% considered it important, while 25% considered it somewhat important. 21% of middle management considered underwriting very important; 37% considered it important; 21% somewhat important; 16% least important and 5% not important. For the finance analysts, 50% considered it very important, while 0% considered it somewhat important. 50% of the consultants considered it very important; 25% somewhat important and 25% least important. Operations considered it least important.

The overall results show that 30% of the respondents consider underwriting very important; 27% important; 23% somewhat important; 17% least important and 3% not important.

Table 4.27 Underwriting Arrangements

<table>
<thead>
<tr>
<th>Designation</th>
<th>Senior Management</th>
<th>Middle Management</th>
<th>Finance analyst</th>
<th>Consultants</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Very Important</td>
<td>30%</td>
<td>50%</td>
<td>21%</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Important</td>
<td>27%</td>
<td>25%</td>
<td>37%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Some what important</td>
<td>23%</td>
<td>25%</td>
<td>21%</td>
<td>50%</td>
<td>25%</td>
</tr>
<tr>
<td>Least Important</td>
<td>17%</td>
<td>0%</td>
<td>16%</td>
<td>0%</td>
<td>25%</td>
</tr>
<tr>
<td>Not at all</td>
<td>3%</td>
<td>0%</td>
<td>5%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.6.2 Efficient Pricing

From the results summarised in Table 4.28, 63% of the respondents consider efficient pricing very important in improving outcome of rights issues; 30% consider it very important, while 3% consider it not important and another 3% somewhat important. For senior management,
finance analysts and operations staff, the combined frequency of very important and important is 100%, while for middle level management it is 95% and 75% for consultants. Overall, the respondents attached a very high level of importance to pricing.

Table 4. 28 Efficient Pricing

<table>
<thead>
<tr>
<th></th>
<th>TOTAL</th>
<th>Senior Management</th>
<th>Middle level management</th>
<th>Finance analyst</th>
<th>Consultants</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Important</td>
<td>30</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Important</td>
<td></td>
<td>63%</td>
<td>50%</td>
<td>63%</td>
<td>100%</td>
<td>75%</td>
</tr>
<tr>
<td>Not at all</td>
<td></td>
<td>30%</td>
<td>50%</td>
<td>32%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Some what important</td>
<td>3%</td>
<td>0%</td>
<td>5%</td>
<td>0%</td>
<td>0%</td>
<td>25%</td>
</tr>
</tbody>
</table>

4.6.3 Analyzing The Shareholder Structure

The study sought to find out the importance of analyzing the mix of shareholder when making rights issues in order to improve their outcome. From the results obtained, 40% of the respondents consider it very important; 37% considered it important; 17% considered it somewhat important, while 7% considered it least important. The overall level of importance placed on this variable by the various designations was generally high, with a range of 75 – 100% for important and very important. The respondents listed additional measures as: participation especially by large investors; technology issues; dilution potential and the timely approval by the regulator.

Table 4. 29 Analyzing the shareholder structure

<table>
<thead>
<tr>
<th></th>
<th>TOTAL</th>
<th>Senior Management</th>
<th>Middle level management</th>
<th>Finance analyst</th>
<th>Consultants</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Important</td>
<td>4</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Important</td>
<td></td>
<td>0%</td>
<td>47%</td>
<td>100%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Somewhat important</td>
<td>75%</td>
<td>32%</td>
<td>0%</td>
<td>50%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Least Important</td>
<td>25%</td>
<td>11%</td>
<td>0%</td>
<td>25%</td>
<td>100%</td>
<td>0%</td>
</tr>
</tbody>
</table>
4.7 Chapter Summary
This chapter has described the research findings as well as presented and explained the data collected in form of figures and tables. Data was collected, presented and analysed on the basis of the research questions.

On investigating the factors that lead to the selection of rights issues, the findings were that the existence of a favourable regulatory environment was the most important factor. The other factors that were considered important were: that rights issues are fairly certain; firms are able to take advantage of temporarily high stock prices; floatation costs are relatively low and that rights issues lead to preservation of ownership and control, in that order.

The study investigated the factors that lead to the success of rights issues and found that they were ranked as follows in order of importance: shareholder take up; the firm’s performance; current trend of the stock market; the purpose for which funds are raised; the subscription price; ownership structure and the presence of underwriting.

The study identified the challenges that rights issuing firms face as: determining an appropriate timing; limited investor base; higher future dividend payment; negative stock price effects and the high cost of contacting shareholders. Finally the following measures were identified as necessary in order to enhance the use of rights issues: efficient pricing; analyzing the shareholder structure and having underwriting arrangements.

The next chapter provides a discussion, as well as conclusions and recommendations of the study.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction
This chapter is divided into four sections that provide: a summary of the study; a discussion of the study; conclusions from the study and recommendations of the study. The summary section highlights the important elements of the study which include the objectives of the study, methodology employed to collect data and the findings of the study. The ensuing subsection provides in-depth discussions on the major findings of the study as they relate to the specific objectives. Conclusions based on the research objectives and the findings obtained in chapter four are documented in section three. Finally, recommendations for further research are contained in the last sub-section.

5.2 Summary
The general objective of the study was to investigate the use of rights issue for corporate financing. The study was guided by four research questions namely: to determine the advantages of rights issues; to determine the factors that affect the success of rights issues; to determine the challenges encountered when making rights issues and to determine the measures that can be taken to enhance the use of rights issues.

The study employed descriptive research design to collect data necessary to meet the specific objectives of the study. Both secondary and primary data was collected for the study. Primary data was collected thorough the use of structured questionnaires. Secondary data was collected for the organisations, websites, the Capital Market Authority and the Nairobi Securities Exchange. The population for this study was organisations that are listed on the Nairobi Securities Exchange and that made rights issues during the study period. This population comprised 18 rights issues, made by 11 organisations. In addition to the rights issuing firms, primary data was also collected from some investment bankers involved in rights issues. The size of sample selected was 30. A descriptive analysis of the data collected was conducted using MS Excel and SPSS. The results were presented in the form of tables and figures.

The study found that firms are concerned about the prevailing regulatory framework when they make rights issues. Out of the factors investigated, this factor had ranked highest with a mean of 3.93 and coefficient of variation of 0.26. A high level of certainty and high stock
prices ranked second and third with a mean of 0.29 and 0.32 respectively. Lastly, lower floatation costs and preservation of ownership and control were less significant, ranking fourth and fifth respectively. Consequently the existence of a favorable environment encourages firms to make rights issues.

On the factors that make rights issues successful, the study found that shareholder take up was the most significant factor. It had a mean of 4.53 and coefficient of variation of 0.15. This implies that the higher the level of rights that are taken up by existing shareholders, the higher the chances of success of a rights issue. Other factors that were also found to be important for the success of rights issues were, a firm’s performance, trend of the market and purpose for which funds are raised.

The study also sought to investigate the challenges associated with rights issues. Of the variables investigated namely: timing; limited investor base; cost of contacting each shareholder; negative stock price effects and higher dividend payments, timing was found to be the most significant challenge that firms encounter. Timing had a mean of 4.20, and a coefficient of variation of 0.19. It was followed by limited investor base and higher future dividend payment, with coefficient variation of 0.22 and 0.28 respectively. Negative stock price effects and high cost of contacting shareholders were ranked fourth and fifth respectively.

There are some measures that can be taken to make the use of rights issues easier as well as to improve the success rates. The study found that timing was very critical in influencing the performance of rights issues. This factor had a low coefficient of variation of 0.19, and ranked first. In addition, pricing was also found to be significant to a large extent, with a coefficient of variation of 0.23. The study however found that underwriting was not very significant in influencing the outcome of right issues.

5.3 Discussion

This section provides a detailed discussion based on specific research objectives as revealed by the research findings and compares the findings with the literature review.

5.3.1 Factors that lead to the selection of rights issues

The findings of this study provided insight into the factors that lead firms to choose rights issues. This was achieved by highlighting the various benefits of rights issues as compared to other means of raising finances. Based on the findings of the study; the presence of a
favorable regulatory environment is the most important determinant in the choice of rights issues. This finding supports the observations of Fung et al. (2008) and Lukose et al. (2003) that market improvements had led to an increase in the number of offerings. Fung et al. (2008) found that the number of public offerings in the Chinese market had grown due to less stringent issuing requirements and better fund raising ability. Some of the improvements that can enhance the use of rights issues include: less stringent issuing requirements and reduced transaction costs.

The study also found that a high level of certainty led firms to use rights issues. This finding is in line with the observation of McLaney (2006) and Ross et al. (2008) that rights issues are almost always successful, since most shareholders exercise their rights. The latter found that only a small percentage of shareholders (less than 10%) fail to exercise valuable rights.

The assumption that firms make rights issues when their shares are overvalued was also investigated and found to be true to a large extent. These findings were in line the findings by Heron et al. (2004) and Lukose et al. (2003), that managers make rights issues when they believe their stock is overvalued.

The study also investigated the characteristic of lower floatation costs that is often associated with rights issues. The results showed floatation costs was important, but not to a very large extent. In their study, Eckbo et al. (2007) observed that floatation costs vary across firms. They further stated that such costs are determined by the characteristics of the issuer as well as the type of security offered. They suggested that specific firm characteristics must be well understood, to determine the floatation costs.

The results of the study did not support the findings of Sukor et al. (2010), that rights issues are driven by the need to avoid dilution of ownership. The need to preserve ownership as factor considered when making rights issues was ranked least by the respondents. Sukor et al. (2010) observed that if every existing shareholder subscribes his allotted number of new shares, then nothing changes in terms of ownership profile. The implication from this therefore is that the need to preserve ownership is not an important consideration. These findings are also in line with those of Eckbo et al.(1992) that owners prefer public issues to rights issues because the former offer more diversification benefits. Barnes et al. (2006) found that public issues are better at facilitating dispersed ownership and minimization of trading spreads, a measure of liquidity, than rights issues. Further, McLean et al. (2010)
stated that controlling shareholders would have a stronger preference for rights in weak investor protection environments, where control is more valuable.

5.3.2 Factors affecting the success of rights issues
Heron et al. (2004) observed that expected shareholder take-up is an important determinant of the rights offering choice. This observation was in line with that of Bohren et al. (1997); Singh (1997) and Eckbo et al. (1992). Similar to the above studies this study found shareholder take-up an important determinant of the success of rights issues. Barnes et al. (2006), found that shareholder uptake is an important influence on abnormal returns reported at issue announcement, price reaction being significantly more adverse where shareholder and in particular block-holder renunciation is high. In line with this, Fung et al. (2008) found that the participation of state and legal-person shares appeared to provide a useful signal to the market for firms’ higher earnings and these firms had higher abnormal returns.

The implication from these studies therefore, is that high participation of block and institutional holders leads to positive market reaction and consequently, better performance of rights issues. Further, Holderness et al. (2012) found that nonparticipation in rights issues causes wealth transfers from those shareholders who do not participate to those who do participate. It is also associated with less successful fund raising and a more negative stock price reaction.

Burton et al. (2003) found that certain characteristics of a firm such as its profitability, size, growth, liquidity and dividend policy affect the success of rights issues. The study found that the performance of a firm is an important determinant to the response and hence performance of rights issues.

The effect of the trend in the market around the time of rights issues was investigated and found to be an important factor from the study. Choe et al. (1993) observed that volume of equity offerings is indeed higher in economic expansions than in recessions, which in line with the findings of this study. The market reaction to rights issues is more positive during seasons of economic boom, while during economic slumps the targeted funds may not be raised.

Another factor that was investigated was the intended use of proceeds and its effect on rights issues. In practice, firms often disclose the purpose for which for which they seek to raise funds in the market. According to Don et al. (2009) when firms disclose specific plans, they
signal high future profits, particularly when funds are used for investment. On the contrary, if no specific plans are disclosed, a rights issue may not be attractive to investors. In line with these findings, the study found that the intended use of rights issue proceeds affected the outcome.

From the results of the study, underwriting was not considered very influential on the outcome of rights issues. While some of the organisations investigated employed underwriters, others did not. Unlike in some jurisdictions where rights issues must be underwritten; this is not the case in Kenya. In China, for example underwriting is mandatory; Fung et al. (2008). Further, Duong et al. (2012) posit that firms may fail to use underwriters when they expect a high stake up. This could explain why some of the issues in the Kenyan market were successful, despite not having an underwriter.

The subscription price an important part in the outcome of rights issues. The study found that this was the case, which supported the findings of Armitage (2002) and Shapiro et al (1999) that the offer price discount is important in determining the market’s reaction to equity issues and in influencing the choice of equity issue method. Further, Fung et al (2008) observed that setting the subscription price below the market price increases take up. The subscription discount also provides an incentive for shareholders to participate in rights offerings (Holderness et al., 2012).

**5.3.3 Challenges Encountered When Making Rights Issues**

From the results of the study, the timing of rights issues was the most significant challenge that rights issuers encountered. These findings were in line with the observation by Eckbo et al. (2007), that the timing of an offering is critical to measure its price reactions. The results further supported the evidence that managers are concerned about the appropriate timing of equity issues by Graham et al. (2001). Issuers are more likely to make rights issues during periods of economic boom, and when the economy is growing. This is so because during such times, they are more likely to pursue more investment and research and development activities. The finding of Qian (2011) supports this presupposition. The important of timing of equity issues has been addressed by various studies: Loughran et al. (1995); Spiess et al. (1995); Baker et al. (2002); Daniel et al. (2006); Pontiff et al. (2008); and David et al. (2009).

Another concern and potential challenge that rights issuers encounter is the fact since rights issues significantly increase the number of shares issued, future dividend payments also
increase significantly. The study investigated this and found it to be a real challenge that is encountered, ranking it third in importance. This is especially in a case where a firm does not performance as well as expected as posited by Sukor et al. (2010). Another view point of the dividend issue is that increased payout reduces the funds available for investment, leading to poor post issue performance (Amidu et al., 2006).

The fact that rights issues target a limited investor base was also investigated and ranked second showing that it is quite important. This is line with the observation by Barnes et al. (2006), that unlike rights offerings, placings are more instrumental in bringing in new shareholders to a firm. McLean et al. (2010) observed that firms in poor countries preferred rights issues, because the shareholders represented a large fraction of the investor base.

The study found that the cost of contacting shareholders during rights issues was the least significant challenge that firms encountered. The implication from this is that firms only made rights issues when it was the most cost efficient way of raising capital. Consequently, they would have to accept the expected costs. The cost of contacting shareholders would be significant when a firm has a dispersed ownership. It would there be expected that only firms with concentrated ownership make rights issues. This observation supports that of Burton et al. (2003).

On the long run effects of rights issues on the performance of a firm, the study did not find rights issues to have a significant impact. Various studies have documented that firms performed poorly after rights issues. These include: Hou et al. (2002); Eckbo et al. (1992); Marsden (2000) and Jensen (1986). These studies observed that rights issues led to negative cumulative average abnormal returns as well as a negative impact on stock prices. The results of the study did not provide support for this. On the contrary the results supported the studies that document that rights issues have no significant effect on firm performance. These include: Nelson (1965); Smith (1977) and Heron et al. (2004). They did not find any significant change in operating performance that could be attributed to the use of rights issues.

5.3.4 Measures To Enhance The Outcome Of Rights Issues
The results of the study showed that pricing was a very important factor in determining the outcome of rights issues. This finding supports that observation by Breuer (2006) that pricing of rights issues is a very critical factor. The pricing of issues has been addresses by various
studies such as: Poitras (2002); Sukor et al. (2010) and Owen et al. (2008). Despite this, it remains a challenge, that requires further understanding. According to Tan et al. (2002), the outcome of rights issues is influenced by the subscription price. The price tends to convey certain information about the firm to the market that ultimately affects the reaction by investors. Rights issues are generally priced at a discount to the prevailing stock market price, other wise they would not be attractive to investors. For this reason firms must carefully determine the optimal price at which to sell rights.

Another measure that was investigated on its ability to enhance rights issue usage was analyzing the shareholder structure. The results indicated that respondents considered this important to a large extent. Shareholder structure varies across firms and jurisdictions. According Barnes et al. (2006), the United States capital market encourages dispersed ownership to improve liquidity. For such a market therefore, firms would be more inclined to make public issues as opposed to rights issues. In the Kenya context, most firms tend to have a good mix of institutional and individual ownership. There has been a trend by the government to sell its stake in certain organisations where it holds a significant portion. Analyzing the shareholder structure of a firm is an important stage when making equity issuance decisions. When the ownership is concentrated, the process of making rights issues is less complex and is faster. Burton et al. (2003) stated that rights issues were more appropriate for firms with large block holdings than for those with dispersed ownership. The number of years a firm has operated could also influence the shareholder structure. Eckbo (2008) observed that firms tended to have less concentrated ownership as they grew.

The final factor that was investigated by this study was the use of underwriting as a means to enhance the outcome of rights issues. Rights issuers may choose to use or not to use underwriting, in jurisdictions where it is not mandatory such as China (Fung et al., 2008). Of the measures investigated, underwriting was ranked last, possibly because various companies made rights issues successfully, without involving an underwriter. Eckbo et al. (2007), observed that using underwriters helped in dealing with challenges such as pricing and timing of rights issues. Balachandran et al. (2009) found that underwritten issues had a higher take up than those that were not underwritten. This would appear to point to better timing and pricing as observed by Eckbo et al. (2007). According to Owen et al. (2003) most rights issues internationally are underwritten and the decision to use underwriters was influenced by issue size, trading frequency, and market risk. This implies that after assessing various factors, a
firm should be able to determine whether to use an underwriter or not. Underwriting cost is a direct cost of rights issues and therefore ultimately affects the net proceeds of the issue. It would therefore be imperative to weigh the underwriting cost against the risk of issue failure in deciding the best decision to take.

5.4 Conclusion
The purpose of this study was to determine the factors that lead firms to choose rights issues, the factors that affect the success of rights issues, the challenges encountered in making rights issues and measures that can be taken to enhance the use of rights issues. The major conclusions from this study based on the findings and discussions are presented below.

5.4.1 Factors that lead to the selection of rights issues
Organisations faced with the need to fund their operations can choose a mode of financing from among various alternatives. The study sought to determine what led firms to prefer rights issues over other means of financing. The findings of the study were that the existence of a favorable regulatory environment that facilitates the making of rights issues was the most significant factor that led firms to use them. Additionally the study found that the high level of certainty associated with right issues as well as the need to take advantage of high stock prices were also significant factors in choosing to make rights issues. The need to preserve ownership and control ranked last among the factors, pointing to the fact it is not a driving factor in making rights issues.

5.4.2 Factors affecting the success of rights issues
The success of rights issues is a critical factor for the issuing firms, in enabling them to raise the targeted capital. The study found that shareholder take-up was the most important determinant of the success of rights issues. It also found that the other significant determinants were the current tone and trend of the stock market and the issuing firm’s performance record. Consequently it emerges that in order for a firm to make a successful issue, it must convince its shareholders to take up the rights, most importantly, as well as assess the stock market carefully to determine the expected outcome. An issuing firm should also have a superior record of past performance to make it attractive to shareholders.

5.4.3 Challenges associated with making rights issues
Firms obviously encounter certain challenges when they make rights issues. The study found that that determining an optimal timing for rights issues was the most significant challenge
that firms encountered. This is because a wrong timing can have adverse effects. Another important challenge experienced was a limited investor base, since rights issues target existing shareholders thereby not giving firms access to a broader range of investors. Also significant was the higher future dividend payments that are a consequence of rights issues. The respondents did not find the cost of contacting each shareholder and negative stock price effects sometimes associated with rights issues, significant challenges to rights issues.

5.4.4 Measures to enhance the success of rights issues

Since rights issues are a significant and viable avenue for raising financing, they should be encouraged and when they are made, their performance should be enhanced as much as possible. The study investigated various measures that can be employed and found that the most important factor was efficient pricing. The study also found that another important factor was analyzing the shareholder structure to determine whether a rights issue was the most appropriate method of raising funds. The respondents did not consider the presence of underwriting a critical factor in influencing the outcome of rights issues.

5.5 Recommendations

This section provides recommendations that the researcher felt are vital to the successful use of rights issues in corporate financing.

5.5.1 Suggestions for improvement

5.5.1.1 Factors that lead to the selection of rights issues

The results from this study indicate that all the factors that were investigated were found to be important in the decision to make rights issues. Consequently, firms that intend to raise significant funding should carefully assess the internal as well as the external environment to determine whether the use of rights issues is appropriate, given their specific circumstances.

5.5.1.2 Factors that influence the success of rights issues

Several factors were investigated for their influence on the outcome of rights issues. Although most of the factors were found to be important, firms should be more concerned about those that are more critical. These are shareholder take up, performance of the firm and the trend of the stock market at the time of issue. Understanding the critical factors should lead firms to put more focus on this and thereby ensure that their issues achieve the desired target.
5.5.1.3 Challenges encountered in making rights issues
This study recommends that rights issuing organisations become aware that timing is very critical. With this in mind, they should then carefully access the environment to determine the timing that would guarantee the desired performance of the issue. Failure to do this would lead to a shortfall in the targeted funds or cancellation of the issue if the minimum subscription is not achieved.

5.5.1.4 Measures to enhance rights issues
From the findings of the study, there should be a lot of focus on determining an optimal subscription price. Understanding how to price their rights efficiently would enable firms to set prices that resonate well with investors and consequently improve the outcome. It is recommended that firms engage experts, such as investment bankers in order to ensure that their issues are well priced. Further, the capital market regulator should introduce measures that encourage more firms to use this avenue to raise funds. These could include a speedy and timely approval process, and less stringent requirements.

5.5.2 Suggestions for Further Research
The study recommends that further research is undertaken to establish the effect that the use of rights issues has on firm performance and stock prices in the long run. The study also recommends that the challenges encountered when making rights issues be addressed, to make them more accessible to a wider scope of firms.
REFERENCES


Duong, T., Singh, R., & TAN, E. J. (2012). What’s Wrong with Rights?


