Right issue announcements and share prices: An event study approach

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Abstract

This paper studies the effect on listed firms' share prices on the Colombo stock exchange to the right issue announcements. This study consists of 85 right issue announcements (69 companies) over the 2012-2019 periods. The analytical tool is an event study methodology in which the market model is used to calculate the abnormal return and show how the abnormal return behaviors around the right issue announcement day. The level of significance used at 5% to test whether the results are significant or not. The observational findings indicate that the average abnormal returns are statistically significant at the right issue announcement day and day before the event. The cumulative average abnormal returns are statistically significant around the right issue announcements date. The results conclude that the right issue announcements are affecting the stock prices. However, there is no such evidence that the market is in a semi-strong form efficiency as a summary of this paper.
Keywords: Colombo Stock Exchange, market model, right issue announcements and share price

Introduction

The stock market plays an essential role in the economy. Companies typically sell their rights as the decision to raise equity capital. If the stock exchange is efficient, the rational investor will react firmly and respond quickly to this newly released information. Moreover, their response will be very efficient and precise. In such situations, most scholars have tried to predict the behavior of stock prices to the right issue announcements and behavior of abnormal returns. The theoretical evidence concluded that the negative price response to the right issue announcements. There are different arguments between results when using a different method in different stock exchanges. Previous studies give the research gap to analyze share prices to the right issue announcement consisting of Colombo stock exchange in the last eight years (2012-2019). This paper's research problem is how to behave the share price to the right issue announcements of listed companies in the Colombo stock exchange. That result will help decision-makers who engage actively in the stock market to recognize the proper impact on the stock prices of listed companies.

Literature Review

AliSabri (2004) analyzed the impact of announcements of the right issue on the companies' share price traded on the Colombo stock exchange. He concluded that the negative abnormal returns and excess returns reported before the right issue announcement day. He suggests that information is released to the public before businesses officially reveal it. As mention by Edirisinghe and Nimal (2015), Bandara (1997) also generated negative results for right issue announcements, and findings have implications for investors, issuing firms, managers, and regulatory agencies when obtained the same results by them. There is a separate argument that has been done by Ramesh and Rajumesh (2014). They said that the positive significant average abnormal returns and cumulative average abnormal returns generated on the event date. They confirmed that the Colombo stock market absorbed good information on the announcement date by using different emerging markets. But the inefficient dimension of information adjusts very slowly to the public information to the decision for investors.

Methodology

The quality of the analysis findings would also rely on the techniques used to retrieve and analyze data. The 85 right issue announcements are selected as the research sample throughout 2012-2019. The secondary data used, and the daily data obtained from the collection of CSE data. The case analysis approach used to measure the impact of the right issues on a share price on the day of the incident (-40, +40), focused on the estimation window (-241, -41). In the event window, the market model's statistical model is used to measure abnormal returns by using excel tools. The market model equation for measure abnormal return is,

$$\boldsymbol{\epsilon R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it}} \quad \text{..........} \quad \text{Equation 01}$$

R_{it} –the period t return on security i.

R_{mt} –the period t return on the market portfolio.

ε_{it} -the zero mean distribution model.

α_i/ β_i–the parameters of the market model.

Results and Discussions

The table1 shows that the positive cumulative average abnormal returns in the event window period (-40, -1) and (-30,-1). Negative values are obtained for others. Cumulative average abnormal returns are statistically significant from event day through the post-event period.

Table 4.Cumulative average abnormal returns and t-statistics for event windows

Event window	(-40,-1)	(-30,-1)	(-10,-1)	(-1,0)	(0,+1)	(-1,+1)	(+1,+10)	(+1,+30)	(+1,+40)
CAAR	0.03	0.03	-0.01	-0.01	*-0.05	*-0.04	*-0.04	*-0.06	*-1.60
t-stat	0.66	0.81	-0.30	-1.52	-5.47	-4.23	-2.18	-1.94	-42.09

** represent statistically significant results at 5% significance level*

Figure 1 shows that the AARs and CAAR lines for the window period (-40, +40).

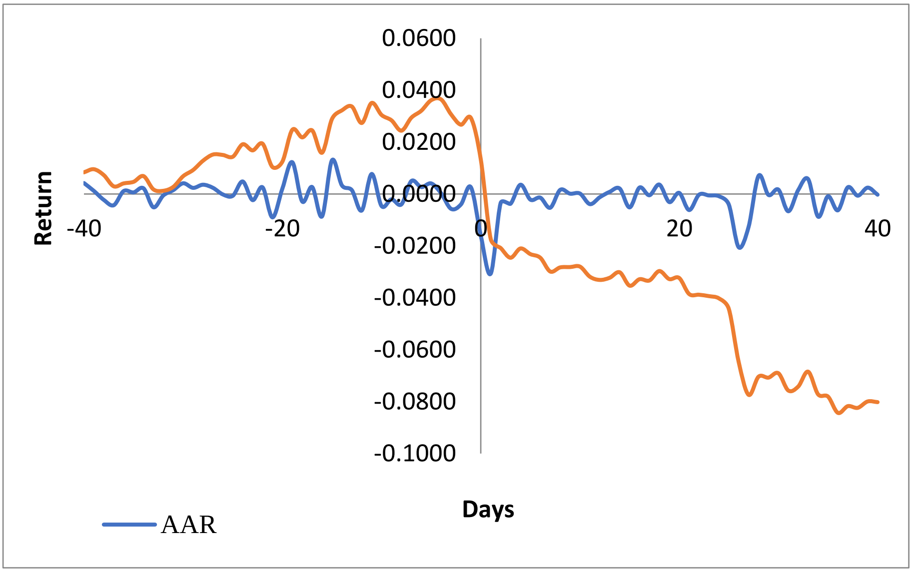

Fig 1. AARs and CAARs Values

There are both negative and positive average abnormal returns during the event window period. The results show the positive average abnormal return on the day before the announcement date but not statistically significant. The cumulative average abnormal returns show positive values until the event day and then show the negative values. The cumulative average abnormal returns are statistically significant around the right issue announcement day. The cumulative average abnormal return line is represented the negative slop from the day before the announcement date. Further below table represents the statically significant abnormal returns.

Table 5. AARs and CAARs for (-10,+10) event window

Day	AAR	T-statistics of AAR	CAAR	T-statistics of CAAR
-10	-0.0036	-0.1786	0.0316	1.5835
-9	-0.0031	-0.1640	0.0285	1.4968
-8	-0.0040	-0.2206	0.0245	1.3572
-7	0.0050	0.2942	0.0295	1.7338
-6	0.0027	0.1676	0.0322	*2.0211
-5	0.0041	0.2769	0.0363	*2.4599
-4	0.0005	0.0394	0.0368	*2.7341
-3	-0.0063	-0.5220	0.0305	*2.5348
-2	-0.0034	-0.3306	0.0271	*2.5963
-1	0.0024	0.2805	0.0295	*3.4603
0	-0.0153	*-2.5417	0.0142	*2.3519
1	-0.0312	*-3.6682	-0.0171	*-2.0052
2	-0.0037	-0.3501	-0.0207	*-1.9874
3	-0.0037	-0.3077	-0.0244	*-2.0288
4	0.0036	0.2662	-0.0208	-1.5484
5	-0.0022	-0.1473	-0.0230	-1.5608
6	-0.0014	-0.0880	-0.0244	-1.5331
7	-0.0053	-0.3113	-0.0297	-1.7454
8	0.0013	0.0721	-0.0284	-1.5735
9	0.0007	0.0368	-0.0277	-1.4559
10	0.0003	0.0140	-0.0274	-1.3742

* represent statistically significant results at 5% significance level

Conclusions and Recommendations

This paper's main primary purpose is to examine the share price changes of an announcement of the right issues to test whether the market confirms a semi-strong version of the hypothesis of market effectiveness. The sample of right issue announcements obtains a negative price impact as previous scholars discussed. There is a positive market response to the right issue announcement throughout the pre-event period. Moreover, proceeds to do so until one day before the announcement day and starts to respond negatively consistently after the announcement date. If the stock market is in semi-strong form efficient, the market responds to the new publicly available information. Thus, new and publicly available information could be used in a semi-strong version of market efficient hypothesis in the strict sense, the valuable method in investment decision making. However, the CAAR curve results represent the negative impact from the day before the announcement date. That means there is an information leakage before the announcement is released in public. The conclusion reached here is similar to that found by AliSabri (2004) for the right issue announcements in the Colombo stock market. He suggested that info is released to the public before businesses officially reveal it. Based on these results, there is no such evidence that the market is semi-strong from efficiency.

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