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Information Content of Right Issue Announcements: A Study of Listed Companies in Colombo Stock Exchange of Sri Lanka

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Abstract
The purpose of this study examines the market reaction to right issue announcements and a test of market efficiency in Colombo Stock Exchange (CSE) by using a sample of 78 events (61 companies) from different sectors of the emerging market during the period 2008 to 2012. Standard event study methodology is employed to find the results. The empirical results show that average abnormal returns (1.54%) is statistically significant at 5% level around the right issue announcement day. This study finds that right issue has a stronger good signal and significant information content in the CSE of the sample companies. On average, market positively reacts significantly to the right issue day. Further, the largest positive cumulative average abnormal returns (7.44%) are observed during the period of (0, +10). This delayed market response supports the inefficient dissemination of information to investors since stock prices adjust very slowly to public information that investors can earn significant abnormal returns by trading in the stocks after the right issue announcement.
Keywords: Right Issue, Market Efficiency, Abnormal Returns, Window Period, and Event Study

1. Introduction

This study focuses on the market reaction to right issue announcements by Sri Lankan listed companies in Colombo stock exchange (CSE). The primary process through which new share of listed companies in CSE is issued as a means to raise equity is a right issue. In a right issue, a company issues its existing shareholders a right to buy additional shares in the company. The company will also set a time limit for the shareholder to buy the shares. The shares are often offered at a discounted price to encourage existing shareholders to take the company up on their offer. Theoretically the right issue should not have any effect on the stock returns, as a right issue nothing but a portfolio of a public issue at the current price and a bonus issue. In an informationally efficient market price, combined with the bonus issue will merely decrease the stock price after the stock goes ex-rights (Akshita and Pitabas, 2012). According to the Shahid, Xia, Mahmood, and Usman (2010) new shares are offered to current stockholder at a specified subscription price that is normally less than what the offering price to the public will be. It enables existing stockholders to maintain their proportionate ownership in the company when the new issues are made, called preemptive right.

Capital market is an important body in contributing to economic development. CSE plays a major role in contributing much towards economic development in Sri Lanka. The CSE is the organization responsible for the operation of the stock market in Sri Lanka. CSE is an important emerging market of the region among the developing countries. The CSE has 15 stock broking firms. 287 companies are listed on the CSE in 2012; most companies' stocks do not frequently trade, representing twenty (20) business sectors with a market capitalization of 2167.6 billion rupees (over US$ 17.3 billion) as at 31st December 2012, which corresponds to approximately 29% of the Gross Domestic Product of the country. The CSE is concentrated two main price indices such as All Share Price Index (ASPI) and Milanga Price Index (MPI). ASPI is used to measure the movement of share prices in all listed companies. MPI is used to measure the movement of share prices of 25 selected companies. These Companies have been selected on the basis of liquidity and market capitalization. With effect from 1 January 2013, the MPI was replaced by a newly introduced index, namely, S&P SL20 index. The S&P SL 20 index, which was introduced on 27 June 2012 to meet investors' demand for a transparent and a rule based benchmark.

Right issue announcements have always been very common phenomena among firms and continue to be one of the least understood topics in finance. The relationship between right issue announcement and stock return has been an interesting topic for researchers. Researchers around the world have studied some of these stock price reactions to firm specific informational events and these studies are known as 'event studies'. Event studies focus on the impact of various announcements like bonus issue, right issue, stock splits, earnings, dividends, mergers and acquisitions, stock repurchases, etc. Initially, event studies were undertaken to examine whether markets were efficient, in particular, how fast the information was incorporated in share price.

Information is a key to the determination of the share prices and the key issue of the efficient capital market (Keane, 1986). An efficient market is one where the stock prices can quickly and fully reflect all available information about the assets. The Efficient Markets Hypothesis ("EMH") states that a company's stock price incorporates the subjective interpretation of all information that could be used to value the company. There are varying degrees of information reflected in prices, which correspond to three forms of the EMH. The "weak" form states that only historical information pertaining to past stock prices is impounded in the current stock price. The "semi-strong" form states that both past stock price information and publicly available information is impounded in the current stock price. The "strong" form states that all available information whether public or private is impounded in the current stock price.

According to Fox and Opong (1999) an efficient market is one in which prices fully reflect available information. An implication of a semi – strong efficient market is that, no abnormal returns can be made from this information because adjustments had already been done in the stock price. The market has already been adjusted; therefore, the only way to outperform the market in this case would be using inside information. Therefore, the objective of this study is to analyze the extent to which a company's stock price would reflect the announcements of right issue according to the semi strong form efficiency which states that stock prices react so fast to all public information and that no investor can earn an abnormal return after the announcement is made.

1.1 Objective of the Study

Following objectives are taken for the study

a. To examine the stock market reaction to right issue information.
b. To find out the degree of the impact of right issue announcement on stock prices.
c. To empirically test efficient market hypothesis (EMH)

2. Literature Review

Abeyaratna, Bandara and Colombage, (1999) examined the semi-strong form efficiency of the CSE in Sri Lanka using Granger causality test and a modified version of the market model on weekly indices of fourteen sectors for the period January 1993 to December 1997. Only three sectors (i.e., bank, finance and insurance; hotels and travels and manufacturing) are found to be semi-strong form efficient. A majority of the sectors lag the market indicating the possibility of predicting market movements of the EMH.

Paul, (2001) analyzed Ex-day effects for rights issues in Hong Kong that confirms an efficient adjustment process and also shows that perturbations from this correlate positively with the proportionate increase in the nominal share capital of the issuer, stemming from the right issue. Rezaul and Peter, (2002) examine whether the stock market valuation impact is consistent with subsequent operating performance of firms. They analysed stock market announcement effect of right issues and observe that a statistically significant stock price decline takes place when companies announce rights issues. Further, stock price decline is also observed during the subscription period. Then analyze post-rights issue operating performance of firms and find that, consistent with the announcement period decline in stock price, rights issuing firms subsequently exhibit a statistically significant decline in their operating performance.

Dissa Bandara and Samarakoon, (2002) investigate the informational content of dividend announcement and analyze the impact of dividend announcement by firm size and dividend growth using a sample from the CSE in Sri Lanka .They find that dividend have a significant information content in Sri Lankan Stock Market. On average, market reacts positively to dividend announcements. The information content is stronger for the smaller firms and for firms announcing high dividend growth. They also find a considerable anticipatory effect for smaller firms, the largest firms and for firms announcing lowest dividend growth. The market takes considerable time to fully incorporate information contained in dividend announcement by the smallest firms, the largest firms, and by firms announcing the highest dividend growth. Overall, the results are inconsistent with an informationally efficient stock market.

Ruth, Chng and Tong, (2002) study private placement and right issue in Singapore for the period 1987–1996. For rights issues, they find higher abnormal returns for firms that undertake larger issues. The issue size reflects the magnitude of favorable news on the issuing firms' earning prospects. When firms announce investment opportunities or capital expenditure simultaneously, the positive impact is even greater.

Shahid, Xia, Mahmood, and Usman, (2010) examine the stock price reaction to the announcement of different equity issues in China. They found that market react positively to the announcement of right offerings while seasoned equity offerings (SEOs) convey negative signals to market. They observed positive market reaction after the announcement of right issues in stock market of China.

Dissa Bandara and Perera, (2011) studied the impact of dividend announcements of CSE in Sri Lanka. They find that significant abnormal returns around dividends announcement day. The results show that overall sample support informational content of dividend hypothesis. This study confirms that the significant anticipatory responses to dividend announcements one week before the event and price adjustment process have been enhanced. Gunnathilaka and Kongahawatte (2011) examined stock splits in Sri Lanka. Stock split announcements create significant positive market reaction and the sharp – adjustments in the stock prices on the day of announcement. It suggests that the market is informationally efficient. The stock's trading volume is improved significantly with the split announcement

Paul, (2011) conduct by analyzing right issue announcement occurring on the South African market between 2001 and 2011 and found that AARs of-2.33%(market model) and -3 (control portfolio). CAARs for five days post the announcement were between -5% and -6%. The share price reactions were found to differ, with statistical significance, according to the financial position of the issuer.

Akshita and Pitabas, (2012) study the stock price reaction to announcement of 205 rights offer of equity in India. They observed positive but statistically insignificant market response to the right issue. The results are consistent with those observed in developing countries. Moreover, the ARs observed around the announcement date hold a negative relationship with decrease in leverage and the price discount offered in the right issue.

Abhay,(2012) attempts to analyze the impact of right issues made by Indian companies on their share prices. He suggested investors were able to generate excess returns around the time of right issues. Moreover, the data of excess returns till ex-date implies considerably higher trading activities after right issue.

Suresh and Gajendra,(2012) examines the market reaction to rights issue announcement news, using a event study methodology for Nifty stocks from 1995 to 2011. There are several theories that have been advanced to explain why companies go for right issue. They found that no evidence of existence of significant positive abnormal returns on day 0. The event has reported negative ARR of -0.048 and it is statistically insignificant. It is also oberserved that there is no significant change in trade volume for the observations stocks during event window. The study concludes that the Indian market reacts negatively to right issue announcement.

Adnan Bashir, (2013) investigates the market reaction to rights issue announcement in Karachi Stock Exchange from 2008 to 2011 who found evidence of existence of positive abnormal returns on event date. However this gain in shareholders wealth is statistically insignificant. This study concludes that the reaction of Karachi Stock Market is an indication of no rights issue announcement effects i.e. no wealth maximization of investors.

3. Data and Methodology

3.1 Sampling Design

The sample consists seventy eight events from 61 companies listed in the CSE which covers during the period 2008 to 2012 using judgmental sampling from different sectors. This choice of the sample period is governed by the availability of data. Reasonable care has been exercised in order to select a large sample to derive more valid findings. The final selection criterion is the availability daily closing price and daily all share price index (ASPI) data in a manner that is necessary for the application of the 'event study method'. Daily closing price should be available for at least 180 days out of the total period of 191 days that include the 180 days estimation period (-11, -180) and the window period 21 days. Therefore, to be precise on testing the market efficiency, this study considers daily data which is important to measure the impact of the right issue announcements using the smallest feasible interval. Therefore, the table 1 reports the 61 sample companies announced 78 right issues for the period 2008-2012. The banks, finance and insurance sectors offered highest right issue, and the lowest right issue was announced by the health care sector.

Table No 1: Description of Sample

Sector Classification	Number of Companies	Percentage of Companies (%)	Right Issues
Banks Finance & Insurance	14	23	19
Beverage Food & Tobacco	5	8.1	8
Hotels & Travels	6	10	9
Investment Trust	6	10	8
Plantations	4	6.5	4
Land & Property	3	05	5
Motors	1	1.6	2
Manufacturing	7	11.4	7
Foot ware & Textiles	3	05	3
Power & Energy	1	1.6	2
Construction & Engineering	2	3.2	3
Diversified	2	3.2	2
Chemicals & Pharmaceuticals	3	05	3
Trading	2	3.2	2
Healthcare	2	3.2	1
Entire Sample	61	100	78

The table 2 shows the breakdown of sample according to year of right issue announcement over the period of 2008 -2012.

Table No 2: of Sample According to Year of Announcement

Year	Total Events
2008	09
2009	09
2010	23
2011	20
2012	17
Entire Sample	**78**

3.2 Data Source

In the present study, we used only secondary data which is the CSE's C-D. The study computes daily returns for individual securities on the basis of daily closing stock prices and its right issue announcement date. In cases where price for the non-traded on a given date, the following traded price is taken as the price for the non-trading date. The market return is calculated as the change in the *daily All Share Price Index'* (ASPI), which is the value-weighted price index of the entire share listed in the CSE.

3.3 Mode of Analyzes

This study uses the 'Standard Event Study Method' (Brown & Warner) to estimate the announcement effect of right issues such as abnormal returns (AR), average abnormal returns (AARs) and cumulative average abnormal returns (CAARs) around right issue announcement (the event-day).The event date is the date on which the effect of an event is presumed to take place, or the date around which a diffused effect is presumed to be distributed. In this study, researcher has taken 21 days around the event, and study has designated -10,-9,-8 …………..,-1 as the 10 days prior to the event, 0 as the event day, and +1, +2, +3………….., +10 days after the event and AARs and CAARs were computed for 21 days surrounding the event-day.

4. Findings

We present descriptive statistics for the stocks returns in our sample. The mean, median, range, standard deviation, minimum, maximum and skewness were calculated for 78 events of the 61 companies' stocks over the 5-year period and are reported in table 3. Standard deviation shows the variation in the mean return. The returns for stocks showed positive skewness. These positive skewed companies would be more attractive for investors to invest in future.

Table No 3: Descriptive and Statistical Information for Sample Companies

AARs	**Value (%)**
Mean	0.4462
Median	0.4130
Standard Deviation	0.7202
Sample Variance	0.5186
Skewness	0.2119
Range	2.7353
Minimum	-0.8762
Maximum	1.8591
Sum for window Period	9.3697
Window Period- Investigation period	21

Table 4, presents the daily percentage average abnormal returns (AARs %), daily percentage cumulative average abnormal returns (CAARs %) and T value of AARs % of the 21 days window period. T (AARs) indicates significance for the investigation period (t= -10 to +10). The number of events with positive and negative abnormal returns in each day is summarized under the column plus (+): minus (-) sign.

Table No 4: Average Abnormal Returns (AARs) of Overall Sample

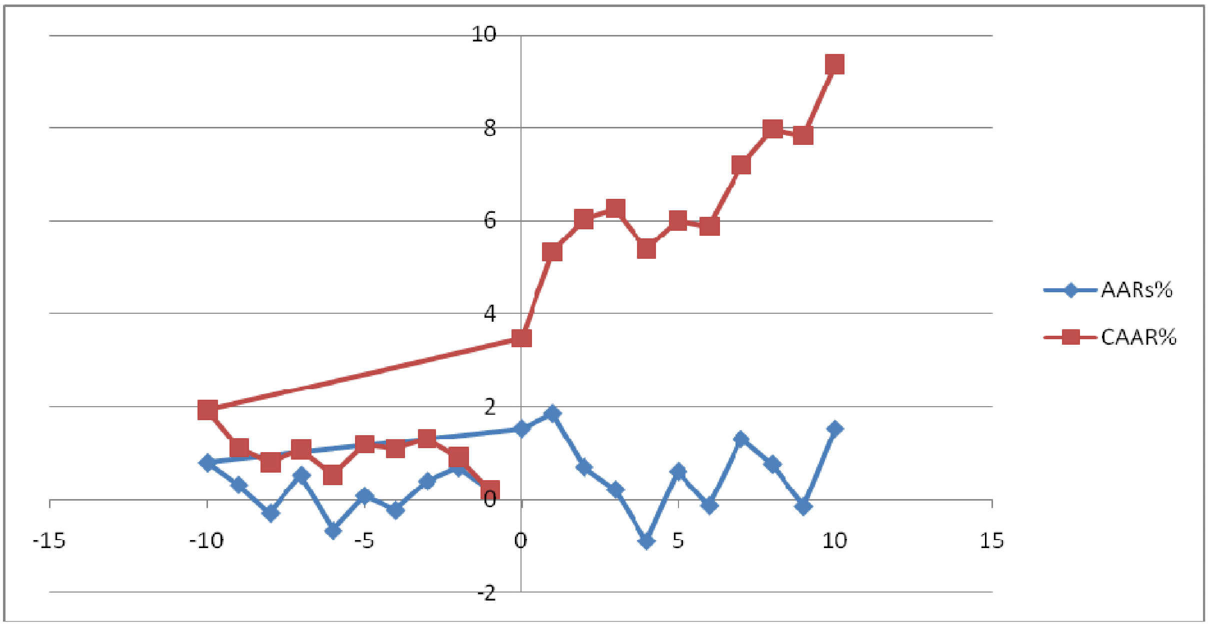
Event Date	AARs%	CAARs%	T(AARs)	Sig.	+ : - Sign
-10	0.21	0.21	0.293		50:28
-9	0.70	0.91	0.967		47:31
-8	0.41	1.32	0.574		46:32
-7	-0.22	1.10	-0.302		40:38
-6	0.09	1.19	0.124		50:28
-5	-0.65	0.54	-0.905		32:46
-4	0.54	1.08	0.753		51:37
-3	-0.28	0.81	-0.385		46:32
-2	0.33	1.13	0.452		51:37
-1	0.80	1.93	1.113		52:26
0	1.54	3.47	2.136	**	48:30
1	1.86	5.33	2.581	**	60:18
2	0.71	6.04	0.982		40:38
3	0.23	6.26	0.314		42:36
4	-0.88	5.39	-1.217		38:40
5	0.62	6.01	0.864		44:34
6	-0.12	5.89	-0.173		39:39
7	1.31	7.20	1.825	*	48:30
8	0.77	7.97	1.072		41:37
9	-0.14	7.83	-0.195		42:36
10	1.54	9.37	2.136	**	49:29
	** Significant at 5 % * Significant at 10%				

The values of AARs presented in table 4 shows that they are minor fluctuating returns both positive and negative returns around the event day. These are positive on 70 percent (7 days) before and after the event day. It is negative on 30 percent (3 days) before and after the right issue announcement day. During the 21 days selected for the study, the AARs are positive for more number of days than they are negative both pre and post the day “0”. Therefore, the trend indicates that it is possible to earn positive returns on most majorities of the days around the event day. The number of positive versus negative sign is 33:31 on the event day and 48:30 on day 1.

The level of significance is used 5% and 10%. In this study, the AARs is significantly lower during pre-event period. We also find magnitude of market reaction of AARs on day 0 is positive of 1.54 %, this is statistically significant at 5% level. This implies that the market absorbs very quickly the favorable signal released by the announcement of the right issue made by the sample companies. Therefore, this evidence suggests that on the right issue announcement day 0 provide stronger signal to the market. It is clearly shown that right issue announcements provide stronger significant positive information to the firms. Interestingly, the largest significant positive AARs of 1.86% is found on day +1, which refers to the first day after the announcement is made due to good signal in the market. It is statistically significant at 5 % level. This means that the return is positive on average during the immediate day after the event day at 95% of the probability. Furthermore, the results of the study suggest that AARs is on day +7 and +10 after the right issue announcement day is also significant at 10% and 5% respectively.

Evidence depicts the CAARs during the (-10, -1) period is 1.93% and the CAARs for the (0, +10) period is 7.44 %. Finally, it is 9.37% over the window period of 21 days. These positive CAARs during the widow period disclosures recommend that right issue announcement do convey good information which market uses in suggesting their stock prices. This slow responsiveness may be attributed to a delay in disseminating the information about right issue to market investors. It has the potential of generating positive AARs based on publicly available information, which runs counter to the inefficient market hypothesis. It may be a result of the inefficiency of the information dissemination process. One important observation regarding the CAARs is that after the announcement day gain kept on increasing. The largest profit shareholders enjoyed in their wealth was on day +10 after the announcement date and that is 9.37%.

Figure 1: AARs and CAARs Values



Event date

Figure 1 outline the value of AARs and CAARs trend in a window period. It has minor fluctuating returns that are both positive and negative before and after the event day. This is clear that positive significant AARs and CAARs are earned on the day of the right issue. It is confirmed that the market absorbs good information on event day.

Table No 5: Direction of Abnormal Returns (ARs) on Day 0

Direction	Number of Events	Percentage of Events
Positive	48	62
Negative	30	38
Total Events	78	100

In addition, table 5 indicates that ARs are evenly distributed over the window period for the 78 events. Results shown as 62 % of the days are positive abnormal returns and 38% of the days are negative abnormal returns. When we compute ARs into AARs (Day "0"=1.54%) which indicates more favorable positive signals than negative signals since some of the sample companies ARs are greater and compensate the negative or less ARs of other sample companies.

5. Discussion

To investigate the information content of right issues announcements on stock returns by examining the sample of 78 events from 61 companies in 15 different sectors of emerging market of the Colombo Stock Exchange (CSE) during the period 2008 to 2012. The results of the study show that there is dominant pattern in positive average abnormal returns (AARs) around the window period. However, AARs of 1.54% are statistically significant (t = 2.136) at 5% level on the event date. Therefore, there is a positive quick market response to announcements on the event day. The empirical results of this study are consistent with many theoretical models suggest that announcements convey favourable information about future operating performance of the companies. The findings of the market reaction to right issue announcements support the informational content of right issue which promulgates the manager's assessment of future potential growth of the firm.

The cumulative average abnormal returns for the (0, +10) period is 7.44%. The large anticipatory and delayed market responses are to be significant imperfection in the process of generation and transmissions of information. This slow response to the right issue announcements of the sample companies is potentially due to the relatively low liquidity of stocks. This findings support with Dissa Bandara and Samarakoon (2002). Further, the result of the study shows evidence for a decrease in the liquidity of the stock after the ex – right issue days. It contrast liquidity hypothesis. The delay and slow adjustment of price in the post announcement period to information implies that the market is informational inefficient. This is difference with informational dissemination process.

This study is not consistent with EMH, it is consistent with the work of Dissa Bandara and Perera (2011) who studied the impact of dividend announcements of CSE in Sri Lanka. Nonetheless, the results of the study of Samarakoon (2005) confirm that the Sri Lankan Stock market is indeed predictable and inefficient in sense of weak–form market efficiency. The result found here contrast with the finding on semi-strong form of efficient market hypothesis. Furthermore, Abeyratna, Bandara, and Colombage (1999) tested the semi-strong version of efficient market hypothesis in Colombo Stock Exchange of Sri Lanka. The result of the study indicates that the majority of the sectors (11 out of 14 sectors) are not a semi-strong form of efficient market. This result also consistently support with inefficient market hypothesis.

6. Conclusion

The study examined right issue announcements in Sri Lanka, in particular whether or not announcements of right issue react on stock price movement. Then test efficient market hypothesis for the emerging market of Colombo Stock Exchange (CSE). This study address how and when the Sri Lankan stock market responds to announcement of right issue. This issue was employed by using the standard event study methodology.

The study found significantly strong market reactions on the right issue announcement day. The information of the right issue was absorbed by the market on the event day (Day "0"), indicated that information was absorbed quickly by the market participations. It is evident from the empirical results of the event day that provide statistically significant at 5% level. The shareholders are able to earn positive AARs of 1.54% to the right issue announcement day. They obtain positive AARs 71% of the days (15 days) and negative AARs 29% of the days (6 days) surround the 21 days window period. This indicates that most of the days earned positive AARs around the event day. There is an evidence of a positive anticipatory effect (CAARs = 1.93%) during the pre announcement period (-10,-1) and also large negative CAARs (7.44%) was observed during the post announcement period of (0, +10) due to investors adjustment slowly to the information and a less amount of time passes before the prices fully incorporates relevant information in right issue announcement. This slow response has the potential of positive generating abnormal returns.

There were fewer attempts taken to study of information content of right issue announcement in Sri Lankan context. The future research could be extended on this phenomenon for different sectors and comparison for effect of bonus issue and cash dividend announcement. Also this study could be further expanded in other areas like stock split, earnings, mergers and acquisitions, stock repurchases and their impact on stock prices. Furthermore, a study can be conducted to extend this study too, since this study considers only a limited number of variables. It is obvious that economic, political variables and trading frequency may be important for determinations of stock prices.

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