

**THE EFFECT OF SEASONED EQUITY OFFERINGS ON STOCK
PRICE PERFORMANCE OF FIRMS LISTED AT THE NAIROBI
SECURITIES EXCHANGE**

BY

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DECLARATION

This research project is my original work and has not been presented for any award of degree or diploma in any other university.

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God bless you all.

DEDICATION

I dedicate this work to my wife Janet and our children Joshua, Purity and Paul.

ABSTRACT

This study sought to examine the effect of the announcement of seasoned equity offerings on the price performance of stocks by looking the behavior of stock returns during the window period. The study was descriptive in nature and involved the investigation of share prices of seasoned equity issuing firms both before and after the announcement of the seasoned equity issues. Stock price performance was measured using stock returns. The effect of the announcement on the stock returns was determined by the significance of the difference between the means of stock returns for the two periods: before and after the announcement day. The study involved 10 firms that made a total of 14 seasoned equity offerings during the period 2004 and 2013.

It was found that stock returns of seasoned equity issuing firms decrease after the announcement of the seasoned equity issue. However, statistical tests of significance showed that the reduction was not significant. Consistent with earlier studies in the area, it was concluded that stock price performance of seasoned equity issuing firms is poor after the announcement of the issues. This study contributes to the existing literature by providing a comprehensive analysis of the short-run stock price performance for a number of firms listed in the Nairobi Securities Exchange.

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LIST OF ABBREVIATIONS

AMEX	- American Stock Exchange
CAR	- Cumulative Abnormal Returns
CMA	- Capital Markets Authority
EMH	- Efficient Markets Hypothesis
GDP	- Gross Domestic Product
IPO	- Initial Public Offering
NSE	- Nairobi Securities Exchange
NYSE	- New York Stock Exchange
ROA	- Returns on Assets
SEOs	- Seasoned Equity Offerings

CHAPTER ONE: INTRODUCTION

1.1 Background of The Study

A seasoned equity offering, also known as a secondary public offering is the issuance of new stock for public sale from a company that has already made its initial public offering. When a publicly traded firm goes to the market to raise funds by issuing equity securities, it typically has a number of choices regarding the issuance methods, ranging from right issues (where shares are offered to existing stockholders), public offerings (where shares are offered to the public) or private placements (where shares are offered for sale privately). The announcement of seasoned equity offerings is a significant corporate event which has the potential to affect security prices.

The behavior of security prices in response to the announcement of major events such as seasoned equity offerings has been explained by several finance theories. These theories include the efficient market hypothesis, the market timing theory and the signaling theory. The efficient market hypothesis, which was developed by Fama (1970), posits that current stock prices fully reflect available information about the value of the firm and that there is no way to earn excess profits by using the information. According to this hypothesis, the market may take one of three forms of efficiency: the weak-form, which assumes that current stock prices reflect all past rates of return and other historical market data; the semi-strong form, where security prices are assumed to fully reflect all of the publicly available information; and the strong form efficiency, which contends that stock prices fully reflect all information from public and private sources. The market timing theory states that stock offerings are motivated primarily by managers' desire to take advantage of open financing windows to sell overvalued equity while exploiting information asymmetry. According to the signaling theory, the pricing an equity issue signals the quality of the firm: issuers of high quality firms are more likely to set a relatively higher price, while the opposite is expected from low quality firms. On the other hand, the issue of secondary equity may signal a fall in earnings which may be interpreted negatively by investors resulting in lower stock prices.

Kenya has registered substantial economic growth since 2003, which was stimulated partly by supportive changes in the macro-economic environment. This period has also seen several firms

conducting secondary equity offerings through the Nairobi Securities Exchange. The NSE provides a trading platform on which publicly quoted firms and the government can offer their securities for sale to investors. Some of the securities traded in the NSE are treasury bills, shares, and corporate bonds.

1.1.1 Seasoned Equity Offerings

Seasoned equity offerings (SEOs), more descriptively termed secondary equity offerings are the issue of stock by a firm that has already completed a primary issue. A seasoned equity offering is a new equity issue by an already publicly traded company or an issue of additional securities from an established company whose securities already trade in the secondary market.

Bayless and Chaplinsky (1996) presented the level of demand for capital as a major determinant of the equity issuance decision. However, equity offerings are essentially the least preferable way of attracting cash and companies will only be inclined to do so when the benefits outweigh the costs. Therefore management will only issue new shares when the market overvalues the shares relative to the beliefs of management. Decisions by the firm's management to attract funds by issuing equity is therefore undertaken if funds cannot be attracted in any other way, or if the shares of the company are overvalued such that the benefits of an issue outweigh the costs.

A firm may issue common stock for a number of reasons: to alter the ownership structure of the firm by introducing new investors, to finance new investments, or to alter the leverage of the firm. Listed companies have the opportunity to raise additional equity by offering equity to the public through the securities exchange.

1.1.2 Stock Price Performance

Stock price performance is the behavior of security prices in response to certain market conditions or events. Individual asset prices are influenced by a wide variety of unanticipated events and some events have a more persistent effect on asset prices than do others (Erleman & Wallestam, 2007). An increase or a decrease in stock price performance is an important indicator of both the market performance of a firm as well its market value.

Stock price performance is measured by the rate of return on the stock. When a stock price is higher than in a prior period, the stock records a superior price performance, and vice versa.

Stock returns are computed by taking the change in market price of a stock over a holding period divided by the price of the security at the beginning of the holding period. Alternatively, stock price performance may be measured by the abnormal rate of return on the stock which is calculated as the actual return on the stock less the expected return for the stock.

1.1.3 Seasoned Equity Offerings And Stock Price Performance

Stock market prices will react to information on the announcement of seasoned equity offerings depending on the informational efficiency of the market. In an inefficient market, which is characterized by some imperfections, stock market prices are not expected to rapidly reflect new information concerning the announcement of seasoned equity offerings. On the other hand, in an efficient market, new information is instantaneously reflected in stock prices and makes it difficult for any participant to possess comparative advantage in the acquisition of information that can outperform the market by generation of abnormal returns. In such a market, there is no significant difference in stock performance between the period prior to the announcement of equity offerings and after the offering announcement.

Empirical studies show evidence of superior stock price performance prior to the announcement of seasoned equity offerings. Stock price performance then deteriorates after the offering announcement and becomes significantly negative during the decision period. For instance, Myers and Majluf (1984), Krasker (1986), Noe (1988), Korajczyk, et al. (1990c), and Lucas and McDonald (1990) predict a negative price effect of an equity issue. This price drop will be larger with larger informational asymmetry and larger equity issue. Lucas and McDonald (1990) show that, on average, equity issues will be preceded by abnormal stock price increases.

1.1.4 Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE), formerly the Nairobi Stock Exchange, was founded in 1954 as a voluntary association of stock brokers registered under the Societies Act. Through the years, the NSE has developed to become the fourth-largest bourse in sub-Saharan Africa.

The NSE was registered under the Companies Act in 1991 and is licensed and regulated by the Capital Markets Authority (CMA). Currently, the exchange comprises of 61 listed companies which have been reclassified to identify them with various sectors in the economy (NSE, 2014). CMA's role is to ensure that companies are only listed if they meet the minimum listing

requirements; whereas, NSE ensures that the companies listed adhere to the set rules and regulations otherwise they are struck off from the trading floor.

1.2 Research Problem

Firms conducting seasoned equity offerings usually record superior stock price performance prior to the announcement of equity offerings, followed by deteriorating stock price performance after the offering announcement and during the subsequent decision period. An explanation for the negative price reaction after the announcement of an SEO is the asymmetry in information between the management of the firm and the investors where managers are inclined to issue equity to exploit overvaluation of their stock. Stock price performance may be positive in a case where there is a favourable information effect associated with investment or when a firm achieves a value enhancing reduction in financial leverage due, for example, to a reduction in the expected costs of financial distress or agency costs. In an efficient market, it is expected that stock prices reflect all publicly and privately available market information. In such a case, there is not expected to be any significant change in stock price performance after the announcement of a seasoned equity offering.

The Kenyan capital market has been punctuated by a number of seasoned equity offerings which were issued through the Nairobi Securities Exchange. Some of the firms that issued seasoned equity offerings are Kenya Commercial Bank, Kenya Power and Lighting Company, Standard Group and others. Although there was an overwhelming investor response in buying seasoned equity offerings, some of the offerings were characterized by declines in stock prices after the announcement of the offerings. It was therefore essential to determine whether changes, positive or negative, after the announcement of seasoned equity offerings are significantly different from the period prior to the announcement of the offerings.

Empirical evidence indicates poor stock price performance for seasoned equity offerings after the announcement of the issue. However, some studies show positive long-run stock price performance after the announcement. In a study by Frijns et al (2006) which focused on stock price performance of seasoned equity offerings in the US market, results showed that stock price performance for both the completed and the withdrawn offerings is poor after the announcement. Shahid et al (2010) examined the announcement effects of seasoned equity offerings in the China

capital markets and found that seasoned equity offerings price effects were significantly negative around the announcement date. Gatundu (2007) studied the effects of secondary equity offerings between January 1996 and December 2006 on the Nairobi Stock Exchange in Kenya. The study measured stock returns cumulative abnormal returns (CARs) and results showed that the price movement in the periods prior to and after the announcement dates resulted in increased abnormal returns for the shareholders although the returns were small. A study by Kiama (2013) dealt with the relationship between seasoned equity offerings and financial performance for firms, measuring financial performance by a financial indicator, specifically the returns on assets (ROA). Results of the study showed an insignificant but positive relationship between seasoned equity offerings and financial performance.

This study distinguished itself from earlier studies that were reviewed. The study was more current and therefore used a more recent sample compared to the one used in earlier studies. While Kiama (2013) measured financial performance using return on assets, which is a financial indicator, this study measured stock price performance by stock returns, which is a market indicator. The study therefore sought to determine whether the short-run stock price performance during seasoned equity offerings was consistent with findings of earlier studies in the subject area and with finance theory. The study sought to answer the question: How does the announcement of seasoned equity offerings affect the market prices of stocks?

1.3 Objective of the Study

This study sought to examine the effect of the announcement of seasoned equity offerings on the price performance of stocks.

1.4 Value of the Study

This study contributes to the existing literature by providing a comprehensive analysis of the relationship between announcement and issue of SEOs and the stock prices of firms during seasoned equity offerings. Researchers can rely on this work to enable them identify areas for further research in the subject area.

Government regulatory agencies and policy makers may benefit from this study by taking into consideration the research findings in the formulation of policies regarding the capital market. Government agencies may also consider the research findings in formulating regulatory policy. Firms trading at the NSE will find the results useful in informing their planning and policy formulation to guide future secondary equity offerings.

It is also envisaged that the study enriches the body of knowledge available for practitioners in the capital market. The research findings may help explain the behavior of stock prices in response to seasoned equity offerings. This will enable both investors and market intermediaries determine their trading strategies around seasoned equity offerings announcements.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter reviews some of the theories upon which the concept of SEOs is based and how they explain the relationship between seasoned equity offerings (SEOs) and stock price performance. The chapter also provides a survey of some of the empirical studies that have been carried out with regard to SEOs and stock price performance.

2.2 Theoretical Framework

The relationship between seasoned equity offerings and stock price performance is explained by a number of finance theories. For the purpose of this study, the theories put into perspective in this section are the efficient markets hypothesis, the market timing theory and the signaling theory.

2.2.1 Efficient Markets Hypothesis

The efficient markets hypothesis (EMH) was developed by Fama (1970) and is built on an older finance theory: the random walk theory. The random walk theory deals with one of the most fundamental and exciting issues in finance – why security prices change and how those changes take place. It posits that that current stock prices fully reflect available information about the value of the firm and that there is no way to earn excess profits (more than the market overall) by using this information. The logic of the random walk is that if the flow of information is unimpeded and information is immediately reflected in stock prices, then tomorrow's price change will reflect only tomorrow's news and will be independent of the price changes today (Fama,1970). Fama divided the overall EMH into three sub hypotheses depending on the information set involved: the weak-form efficiency, the semi-strong efficiency and the strong-form efficiency.

The weak-form efficiency hypothesis assumes that current stock prices reflect all information security market information, including historical sequence of prices, rates of return, trading volume data, and other market generated information. This hypothesis implies that past rates of

return and other historical market data should have no relationship with future rates of return. The semi-strong efficiency hypothesis asserts that stock prices adjust rapidly to the release of all public information. In other words, security prices fully reflect all of the publicly available information. The hypothesis implies that investors who base their decisions on any new information after it is public should not derive above-average risk-adjusted profits from their transactions, considering the cost of trading because the security price already reflects all such new public information. The strong-form efficiency hypothesis contends that stock prices fully reflect all information from public and private sources. According to this hypothesis, no investor has monopolistic access to information relevant to formation of prices such as to have advantage on the market in predicting prices since there is no data that would provide any additional value to the investors.

The EMH is a major theory that explains the rate at which markets process information and reflect it in stock prices. Inasmuch as the three forms of market efficiency hypothesized by Fama serve as a guide to studies on market efficiency, the strong form of market efficiency may rarely find application in the real market practice. For instance, this form of market efficiency hypothesizes frictionless market conditions where there are no transactions costs in trading securities, all available information is costlessly available to all market participants, and all agree on the implications of current information for the current price and distributions of future prices of each security. This is not descriptive of markets met in practice.

2.2.2 Market Timing Theory

The market timing hypothesis, proposed by Loughran and Ritter (1995), states that stock offerings are motivated primarily by managers' desire to take advantage of open financing windows to sell overvalued equity. According to this theory, managers also exploit information asymmetry. By definition, information asymmetry exists in transactions in which there is an imbalance of information, with one party to the transaction having more valuable information that has the potential to influence the outcome.

The Myers and Majluf (1984) model, drawing from Akerlof (1970), argues that insiders, and particularly managers, have more information concerning the firm's prospects than outside investors and will be inclined to issue equity when they believe that their stock price is

overvalued by the market. Jung *et al.* (1996) suggest that since managers are aware of negative stock price reaction to the announcement of a proposed SEO, they time new offerings in order to reduce the impact of information asymmetry, which often coincides with periods of superior stock price performance. This period is also referred to as the “window” of opportunity.

Baker and Wurgler (2002), on the other hand, hypothesized that firms issue equity to “time” the market, that is, they issue equity when it is overvalued by irrational investors who do not revise their valuations to reflect the information conveyed by the equity issuance. As a result, the operating performance peaks at the time of the equity issue, and the post-announcement stock-price decline reflects over extrapolation by investors of the pre-issue trend in operating performance. This implies that investors can be irrational and do not price issuers’ stocks accurately following the SEO announcement. The market timing hypothesis is a generally accepted explanation of the poor long-run stock performance following SEOs (De Angelo *et al.*, 2007).

The market timing theory heavily relies on the concept of information asymmetry in which insiders to the firm are assumed to have more valuable information than those outside the firm. Although this proposition relates with what happens in daily business, it may not be the case in an efficient market, where investors have access to both public and private information and therefore insiders, especially managers cannot take advantage of information asymmetry to over-value the firm’s securities.

2.2.3 Signaling Theory

This theory suggests that an issuer, through the action of pricing an issue, signals the quality of the firm. Proponents of signaling theory also argue that security issuers of high quality firms are more likely to set a relatively higher price, while the opposite is expected from low quality firms. Low quality firms run the risk of offer failure if they attempt to imitate the high quality firm’s pricing strategy. Investors understand this, so they view new stock sales as a negative signal.

The Leland and Pyle (1977) signaling effect implies that sales of shares by better-informed investors signal that they believe shares are overpriced. Miller and Rock (1985) further add that SEO issuance may signal a fall in earnings which may be interpreted negatively by investors resulting in lower stock prices. Managers are often aware of the firm’s cash flows, its retention of

earnings, sales prospects and the need for capital and research expenditure which motivates them to select the optimal method of financing. A securities issue (debt or equity) may signal an (unexpected) need for cash, and thus an expected decrease in operating cash flows.

The signaling theory is also based on information asymmetry and its relevance is subjects to the constraints highlighted in the earlier discussion on market timing. However, the signaling theory remains significant in explaining the reactions of both informed and un-informed investors to seasoned equity offerings.

2.3 Determinants of Stock Price Performance

Stock market prices are influenced by a myriad of factors prevailing in the market environment at a given time. These include the announcement of significant economic events, corporate earnings, the strength of management, macroeconomic fundamentals, government policy, and investor perceptions.

The announcement of economic events introduces news in the market environment which is usually reflected in share prices depending on market's perception of their significance. Some of the significant announcements include those of seasoned equity offerings, mergers and takeovers, payment of dividends, etc.

Information on a company's performance and growth prospects is very important in determining a company's share price. Demand increases for the shares that have a high prospect for growth (blue chip shares). The prices of such shares rise much faster than those of companies whose growth prospects are bleak. The expected receipt of dividend income is sometimes an incentive for investing in a given stock, particularly if the yield on the investment exceeds the return offered on other alternative investments like savings accounts. Investors may pay a premium for shares in issue. The less liquid the shares are, the more difficult they are to come across and one may have to pay a premium in order to get them.

The strength of the management team plays a very crucial role in determining the price of a share. Changes in the management team affect both the risk and returns associated with the counter. If the incumbent management team is perceived to be strong due to its past performance, changes in such a team can result in the dropping of share price and vice versa.

Interest rates and inflation also have an effect on share prices. Where real interest rates are negative, investors tend to seek alternatives that yield positive returns and shares are one such alternative. As investors move from the money market to the NSE, share prices are likely to increase due to increased demand. When investors are assured of positive real interest rates on the money market they are more likely to invest on the money market where returns are guaranteed instead of the stock market where returns are uncertain. The exchange rate also has an effect on share prices as it affects the companies that either export or import.

Changes or proposed changes in the system of taxation, government spending and monetary policy can have an important effect on people's willingness to buy or sell shares. Investors may decide to invest in loan stock or common equity depending on the taxation rate. Treasury bills are an alternative investment to shares; and any changes in their rate of interest is likely to affect the demand for shares and other securities and hence their prices.

Share price movements are also explained by the perceptions of the investors. For example in a bull market share prices are expected to rise and in a bear market they are expected to fall. Investor sentiments may be demonstrated through the seasonality of stock markets. For instance, share prices are usually anticipated to fall during the festive season. This compels some investors to redeem their shares just before the beginning of the festive season so as not to experience capital losses. The level of confidence of the investors in the general economy and economic policies of the country also impact on the share prices.

2.4 Empirical Review

Asquith and Mullins (1986) investigated the effect on stock prices of seasoned equity offerings. The study examined the announcement day and issue day price effects of both primary and registered secondary issues of seasoned equity. A sample of 531 registered common stock offerings by utilities and industrial firms was analyzed. The stock offering took place between January 1963 and December 1981 and firms under study were listed on the ASE or NYSE at the time of the stock offering. The results demonstrated that the announcement of equity offerings reduces stock prices significantly. For industrial issues, regression results indicated that announcement day price reduction is significantly and negatively related to the size of the equity offering. The results appeared not to be explained by changes in capital structure associated with

the equity offerings. The findings were consistent both with the hypothesis that equity issues are viewed by investors as negative signals and with the hypothesis that there is a downward sloping demand for a firm's shares. The price effects for utilities firms were smaller than those observed for industrial issues, and there was no relation between the timing of utility issues and stock price performance. This suggested less informational asymmetry due to the regulations that were in place during that time period.

Loughran and Ritter (1997) examined the operating performance of firms conducting seasoned equity offerings in the US capital market. The study sought to determine whether the post-issue operating performance of issuers deteriorate relative to comparable non-issuing firms. A sample consisting of all seasoned equity offerings of operating companies during 1979 through 1989 on the NYSE, AMEX, and Nasdaq stock exchanges was used. The operating performance of issuing firms was measured by numerous accounting measures such as the median profit margin, the median return on assets (ROA), and the median operating income to assets ratio. The results of the study showed a substantial improvement in operating performance of issuing firms prior to the offering, but then deteriorates. Many of the issuing firms had improvements in profitability before the offering and declines in profitability after the offering.

Corwin (2003) carried out a study on the determinants of under pricing for seasoned equity offerings. The study sought to comprehensively analyze the determinants of under pricing for a sample of 6,637 U.S. common stock offerings that took place from January 1980 through December 1998, excluding initial public offerings, units, rights, mutual conversions, and issues by non-U.S. firms, closed-end funds, or utilities. Using both trade and quote data, the study developed and tested hypotheses related to uncertainty and asymmetric information, price pressure, manipulative trading and pre-offer price changes, transaction costs, and underwriter pricing practices such as offer-price rounding and pricing at the bid. The study focused on the relative importance of these factors in explaining the cross section of seasoned offer pricing and differences in SEO under pricing over time. Consistent with evidence from the public offerings literature, the findings indicated that SEO under pricing is positively related to the level of uncertainty about firm value. It was found that large price moves in either direction lead to more under pricing. However, there was little evidence of a reliable relation between SEO under pricing and proxies for asymmetric information such as firm size and bid-ask spread.

Kim and Park (2005) carried out a study in the United States of America to examine the relations between earnings management by firms offering seasoned equity issues and the pricing of their offers. The study sample of SEOs was obtained from Securities Data Company's (SDC) New Issues Database and an initial sample of U.S. common stock offerings between 1989 and 2000, excluding IPOs, was collected. The study hypothesized that SEO firms that employ aggressive accounting decisions also more aggressively push up their offer prices to obtain higher proceeds from their offerings, and the offer day closing price does not increase as much as the offer price. For the purpose of measuring under pricing, it was defined as the closing market price on the offer day minus the offer price, divided by the offer price. The study employed discretionary accruals as a proxy for earnings management, where a firm's total accruals for a given quarter was defined as the earnings before discontinued operations and extraordinary items less operating cash flows. Three-stage Least Squares Estimation was used to test for the relation between SEO under pricing and earnings management behavior, while also incorporating endogenous determination. The results of the study indicated that SEO firms that make opportunistic accounting decisions issue new shares at inflated prices. The findings remained robust after controlling for other determinants of SEO under pricing and the possible endogeneity of pricing and earnings management.

Frijns, Navissi, Tourani-Rad and Tsai (2006) sought investigate whether completed versus withdrawn equity offerings resulted in different stock price performance prior to announcement and between announcement and withdrawal or completion. The investigation was on stock price performance prior to equity offerings announcements and between the announcement and actual completion or withdrawal. Stock price performance was measured by cumulative abnormal returns (CARs). The study was conducted on the USA capital market and data on completed and withdrawn SEOs was obtained from the Security Data Corporation's Platinum, New Issues Database. The database covered all SEOs from 1984 until 2000. It was found that stock price performance is strong only for firms that later complete the offerings. Firms that withdraw their offerings have poor stock price performance even before the announcement. Additionally, it was found that stock price performance for both the completed and the withdrawn offerings is poor after the announcement. However, contrasting with prior research, they realized that firms complete their equity offerings, even though their stock price performance deteriorates.

Gatundu (2007) sought to determine the effects of secondary equity offering on stock returns of firms quoted on the Nairobi Stock Exchange in Kenya. Specifically the study examined the effect of announcement of secondary equity offerings on stock prices as well as the impact of the announcement on trading volume before and after the secondary issue. A sample of 10 companies that had issued secondary shares between January 1996 and December 2006 was selected. The research was an event study around the date of seasoned equity issues. Stock returns was measured using daily cumulative abnormal returns (CARs), where abnormal return was defined as actual return less expected return. Data was analyzed using a simple times series model. The study established that the price movement in the periods prior to and after the announcement dates resulted in increased abnormal returns for the shareholders. The abnormal returns were however very small and this meant that the details of a secondary issue or rights issue did not shock the market in a significant way. From the averages carried out in the data analysis the amount of shares traded was more at the post announcement period than in the pre-announcement period for most companies involved in the study.

Kiruri (2009) studied the stock market reactions to macro-economic announcements in Kenya. The objective of the study was to test the information efficiency of stock prices at the NSE in relation to macro-economic factors. This was done by finding out how the stock prices in NSE do vary with GDP announcement and also determining whether there is a relationship between NSE stock prices and balance of payment announcement. The research was based on all the listed companies at Nairobi Stock Exchange between the year 2005 and 2008. Stock market reactions were measured by the changes in share prices of the firms in the sample. Secondary data on share prices was extracted from published reports and analyzed using simple linear regression and correlation analysis. The study showed a positive variation between the stock prices at the NSE and the GDP announcement. Results also showed the existence of a very strong relationship between the NSE stock prices and balance of payment announcement.

Shahid, Xinping, Mahmood and Usman (2010) conducted a study to examine the announcement effects of seasoned equity offerings in China. The study examined the stock price reaction to the announcement of different equity issues in China. The study viewed three successive announcement dates for SEOs as event dates; namely, board of directors meeting date, shareholders' meeting date and announcement date to public. A sample of 565 observations of

rights offerings and 152 observations of seasoned public offerings for a period of 1998-2008 was considered. In considering sample inclusion, the study considered the offerings that had identifiable board of directors meeting dates, shareholder's meeting date and announcement date along with the data required for the calculation of abnormal returns around these three event dates. Data about the stock issues and date was collected from Wind database while all the data on prices were collected from Chinese Center for Economic Research (CCER). Findings suggested that market react positively to the announcement of rights offerings while SEOs convey negative signals to market. Consistent with earlier studies on rights issues announcement effects around different event dates, SEOs price effects were found to be significantly negative around the board of directors meeting date. For shareholders' meeting date less significant response was observed, while around announcement date again more negative significant returns were observed, more than shareholders' meeting date but less than board of directors meeting date.

Bayless and Jay (2013) researched on what motivates seasoned equity offerings using evidence from the use of issue proceeds. The study was done in the United States of America with a purpose of discovering how firms use issue proceeds from SEOs. The sample consisted of all SEOs made during the 27 year period from 1970 through 2006 by firms listed on the NYSE, AMEX, and Nasdaq stock exchanges. Data on issues were obtained through SDC Platinum. The study analyzed six motives to issue along with their empirical proxies. Total Sources were defined as equal to Issue Proceeds plus Other Sources. A time series regression was then conducted for 4 years following the SEO for the six use categories. The dependent variable was one of six use categories and the independent variables were issue proceeds, other sources, and control variables. Findings indicated evidence that issue proceeds were funneled into cash, capital expenditures, and acquisitions but these did not seem to be the primary use. While the results suggested a motive for issue that did not rely on behavioural theories, the study suggested a need for investment theories to reconcile the weak post-issue performance of SEO firms with the fact that, in general, research and development investment is associated with positive abnormal returns and operating performance. There was evidence that was consistent with equity issues being made in reaction to exogenous reductions in required returns and during periods when growth opportunities are more plentiful.

Kiama (2013) did a study to establish the relationship between seasoned equity offerings and financial performance for firms listed at the Nairobi Securities Exchange. Financial performance was defined as how well a firm uses the assets from its business in order to generate revenues and realize its economic goals. Financial performance was measured using the rate of returns on assets (ROA). The study used secondary data from published audited annual reports of accounts of the sampled firms which was obtained from Nairobi Securities Exchange and Capital Market Authority. The sample comprised of 10 out of 21 firms that had issued seasoned equity as at 31st December 2012. The research findings showed an insignificant but positive relationship between seasoned equity offerings and financial performance. Results also indicated a significant positive relationship between financial performance, asset growth and leverage.

Gachuhi (2013) conducted a study to establish the signaling effect of bonus issue announcement on stock prices of companies quoted at the NSE. The study was concerned with the establishment of the information content of bonus issue announcement on share performance at the NSE. A sample of 10 firms out of 62 companies listed in the NSE was selected. Secondary data collected from the NSE was used. Abnormal returns on the individual stocks and the trading activity ratio (TAR) were used to measure the variables under study. Results of the study showed that abnormal returns after bonus issue were significantly higher than abnormal returns before bonus issue. Results also indicated that actual stock returns were significantly higher after bonus issue than before the bonus issue. It was concluded that the market return is a good predictor of stock returns and that market return had a positive and significant relationship with the actual returns.

2.5 Summary of Literature Review

The study by Asquith and Mullins (1986) on the subject of seasoned equity offerings became a significant point of reference for subsequent studies by Loughran and Ritter (1997), Frijns et al (2006), Corwin (2003) as well as Shahid et al (2010). Loughran and Ritter (1997) examined the operating performance of firms conducting seasoned equity offerings in the US capital market while Frijns et al (2006) focused on stock price performance of seasoned equity offerings in the same market by looking at both completed and withdrawn offerings. Corwin (2003) studied the determinants of under pricing for seasoned equity offerings in the USA and Shahid et al (2010) examined the announcement effects of seasoned equity offerings in China.

Gatundu (2007) examined the effects of secondary equity offerings between January 1996 and December 2006 on the Nairobi Stock Exchange in Kenya. In the study, stock returns were measured using daily cumulative abnormal returns (CARs). Other Kenyan studies reviewed were those of Karuri (2009), which evaluated the information efficiency of stock prices on the NSE in relation to the announcement of the GDP; Gachuhi (2013), which mainly tested the signaling effect of bonus issue announcement on stock prices of companies quoted at the NSE; and Kiama (2013) which dealt with the relationship between seasoned equity offerings and financial performance for firms as measured using returns on assets.

Due to the passage of time and differences in the variables used in the reviewed studies, there was need to determine whether findings of prior studies in the subject area still held, and whether findings of this study relate in any way to those done in developed markets.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes how the research is designed, identification of the population of study, and data collection and analysis.

3.2 Research Design

The research design was descriptive. A descriptive research sets out to collect, organize and summarize information about a phenomenon. The object of a descriptive research is to portray an accurate profile of events or situations. In the case of this study, which is an event study, a descriptive research would enable the description of the relationship between the announcement of seasoned equity offerings and the performance of stock prices around the announcement date.

3.3 Population of Study

The population of the study comprised of all the firms quoted in Nairobi Securities Exchange as at 31st December 2013 which, according to the NSE, were 62. However, since the study focused on firms that issued secondary equity between 2004 and 2013, only 11 firms met this requirement. The period of study was a decade that experienced stimulated economic activity in Kenya compared to prior periods.

3.4 Sample

Out of the 11 firms that issued seasoned equity between 2004 and 2013, 10 firms were selected for study. The 10 firms made a total of 14 seasoned equity offerings with some firms making more than one equity offering during the stipulated period (see Appendix 2).

3.5 Data Collection

The study used secondary data collected from the NSE. Of particular interest was data concerning the daily stock prices of firms issuing SEOs. In the study, an explicit distinction was

made between the pre-decision period, which is the period before the announcement date, and the decision period, which is the period after the announcement of the seasoned equity offering. The pre-decision period was the event window at least 30 trading days before the announcement of an equity offering was made. The decision period was the event window after the announcement until the actual completion of the equity offering. For the purpose of this study, the decision period was restricted to 30 days after the announcement day.

3.6 Data Analysis

The event study methodology was initiated by Fama et al. (1969) to examine abnormal returns. Generally, an event study involves defining the event of interest, estimating the variables in the control period, calculating the abnormal component, and finally, testing if the abnormal component is statistically significant.

This study was concerned with market reaction around the seasoned equity offerings announcement. Around the time of announcements the study distinguished between the pre-decision period and the decision period. For each of the firms in the sample, the stock returns to the stock for each trading day was computed. For the pre-decision period, the daily stock returns was analyzed using the simple linear regression model to determine the relationship between the daily rate of return to the stock and the daily rate of market returns. This resulted in the derivation of the formula:

$$R_t = a + bR_m$$

where:

R_t is the rate of return to the stock for each day

a is the intercept of the regression

b is the slope of the regression line

R_m is the rate of market returns for each day

The trend equation was then used to compute the expected returns for the decision period. Being a longitudinal study, stock price performance was compared between two periods: the period prior to the announcement of seasoned equity offerings and the period after the announcement.

In the regression model $R_t = a + bR_m$, the value of b represents the *beta* of the stock and it defines the rate at which the returns on the stock change in reaction to market returns. The expected returns computed using the regression model were compared with actual stock returns to derive the abnormal returns for each day, calculated as follows:

$$AR_t = R_t - E(R_t)$$

where;

AR_t is the abnormal rate of return for each day

R_t is the rate of return on the stock for each day

$E(R_t)$ is the expected rate of return for the stock for each day based on the market rate of return

It was expected that if the market is efficient, the cumulative abnormal returns for each firm in the sample would equal to zero.

3.6.1 Operationalization of Variables

Returns were measured by the changes in market price of a security plus over a holding period divided by the price of the security at the beginning of the holding period. This formula is expressed as follows:

$$R = \frac{(P_1 - P_0 + D_1)}{P_0}$$

where:

R is return on the security

P_1 is the price of the security at end of the holding period

P_0 is the price of the security at beginning of period

D_1 is any income received over a holding period

3.6.2 Tests of Significance

A reliability test was conducted for the differences between interval periods, that is, whether the stock price performance in the two event windows differ significantly from each other. Assuming the mean of the stock returns in the pre-decision period was m_0 and that of the

decision period was m_1 , the statistical test would determine whether m_1 is significantly different from m_0 for each firm studied. The following hypotheses were tested using the parametric t-test:

H_0 : $m_0 = m_1$ (i.e. there is no significant difference between the means)

H_A : $m_0 \neq m_1$ (i.e. there is significant difference between the means)

A significance level of $\alpha=5\%$ was used as the decision criteria.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter consists of data analysis, findings and interpretation on the data gathered to address the objective of the study. Descriptive statistics and charts are also presented in the chapter.

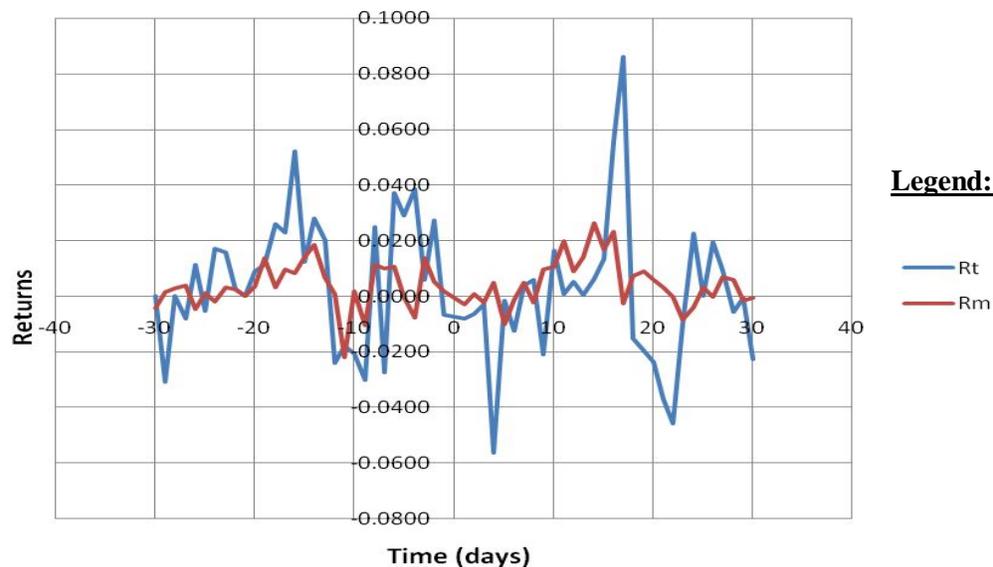
4.2 Stock And Market Returns During Event Window Period

The following time series charts present the behavior of both the individual stock returns and the market returns during the seasoned equity offerings period. In the charts, time zero (0) is the announcement day, the pre-announcement period ranges from day (-1) to (-30) and the post-announcement period ranges from day 1 to 30. The vertical axis represents Returns while the horizontal axis represents Time (days). The line coloured blue in the charts represents stock returns (R_t) and the line coloured red represents market returns (R_m).

4.2.1 Diamond Trust Bank Ltd (2006)

In the SEO by Diamond Trust Bank Ltd in 2006, it was found that mean stock returns reduced from 0.0072 during the pre-announcement period to -0.0016 during the post-announcement period. Cumulative abnormal returns during the post-announcement period were found to be -0.3091.

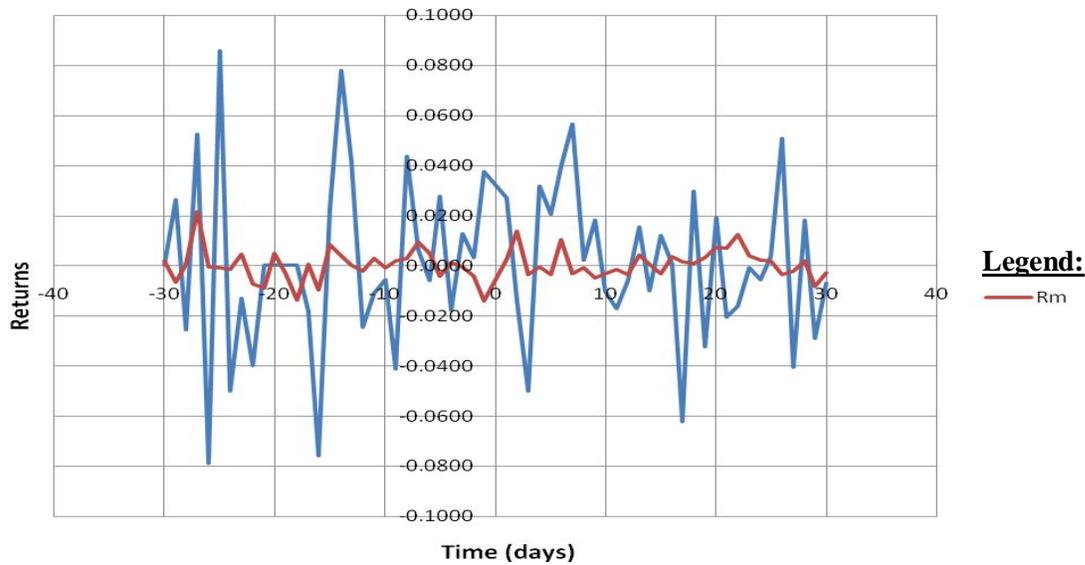
Chart 4.1 Returns for Diamond Trust Bank Ltd



4.2.2 Olympia Capital Holdings Ltd (2006)

The SEO was made in 2006 and the results show that mean stock returns reduced from 0.0010 during the pre-announcement period to 0.0007 during the post-announcement period. The cumulative abnormal returns during the post-announcement period were -0.0635.

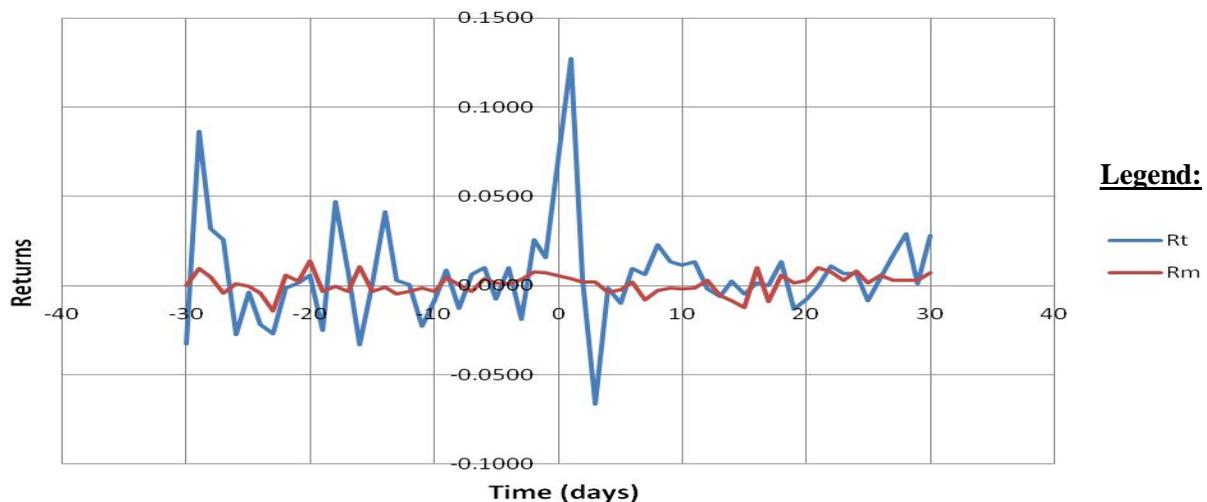
Chart 4.2 Returns for Olympia Capital Holdings Ltd



4.2.3 NIC Bank Ltd (2007)

In the SEO by NIC Bank Ltd in the year 2007, it was noted that mean stock returns increased from 0.0027 during the pre-announcement period to 0.0069 during the post announcement period. Cumulative abnormal returns were 0.1197 during the post-announcement period.

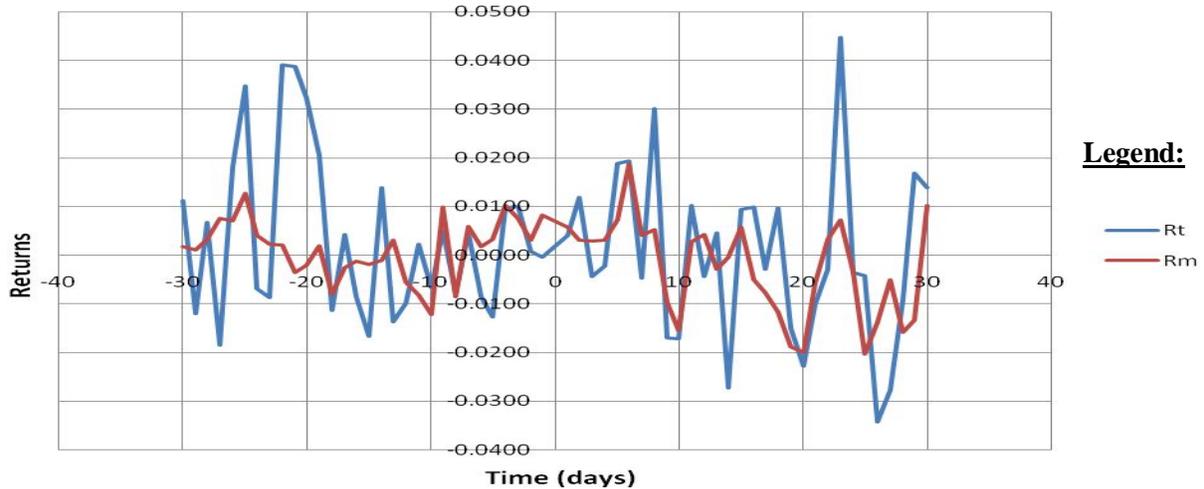
Chart 4.3 Returns for NIC Bank Ltd



4.2.4 Diamond Trust Bank (2007)

In this SEO by Diamond Trust Bank in 2007, it was noted that mean stock returns reduced from 0.0036 in the pre-announcement period to -0.0003 during the post-announcement period. Cumulative abnormal returns during the post-announcement period were -0.0403.

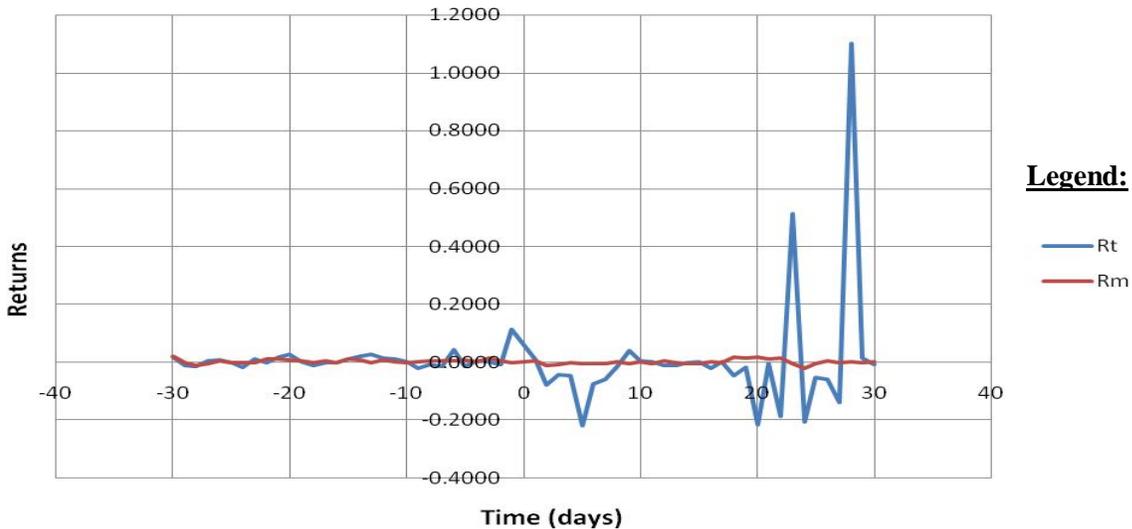
Chart 4.4 Returns for Diamond Trust Bank



4.2.5 Housing Finance Company Ltd (2008)

In the SEO by HFCK in 2008, it was found that mean stock returns reduced from 0.0083 during the pre-announcement period to 0.0069 during the post-announcement period. The cumulative abnormal returns during the post-announcement period were -0.0058.

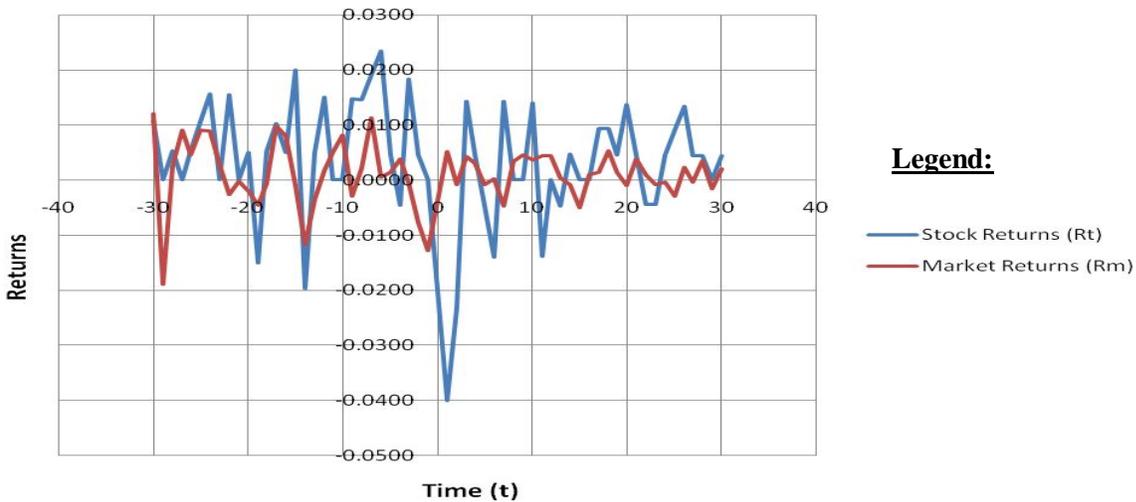
Chart 4.5 Returns for Housing Finance Company Ltd



4.2.6 Standard Chartered Bank Ltd (2010)

Study findings show that the mean stock returns reduced from 0.0063 during the pre-announcement period to 0.0008 during the post-announcement period. The cumulative abnormal returns during the post-announcement period were -0.1661.

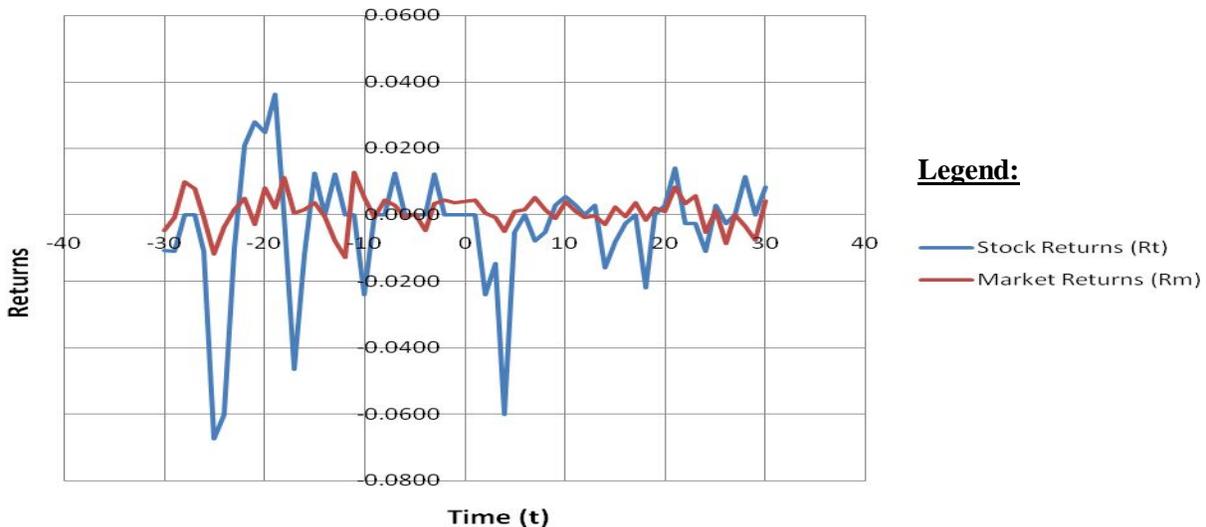
Chart 4.6 Returns for Standard Chartered Bank Ltd



4.2.7 Kenya Commercial Bank Ltd (2010)

Results show that the mean stock returns reduced from -0.0032 during the pre-announcement period to -0.0045 during the post-announcement period. During the post-announcement period, cumulative the cumulative abnormal returns were -0.0003.

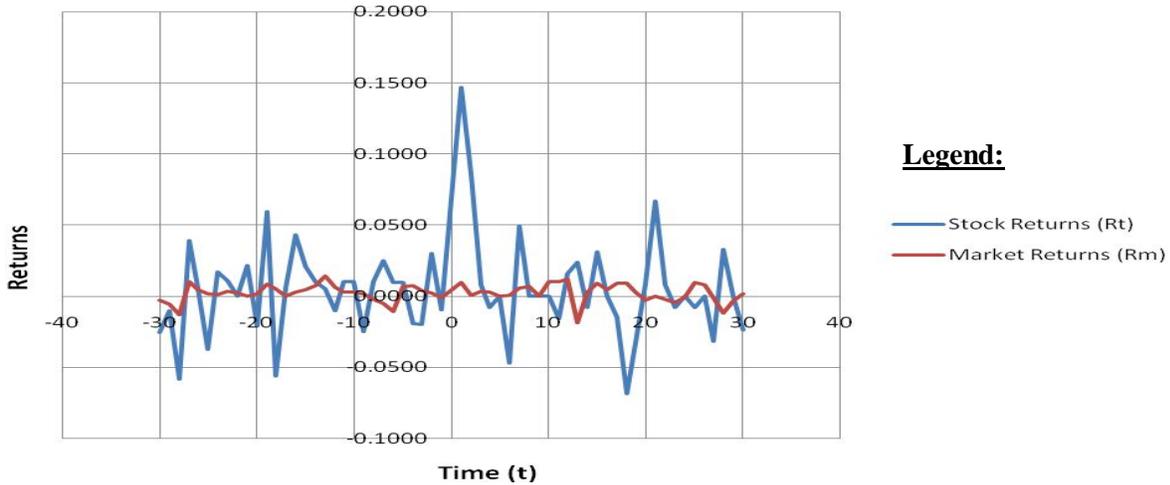
Chart 4.7 Returns for Kenya Commercial Bank Ltd



4.2.8 TPS East Africa (Serena) Ltd (2010)

The results show that the mean stock returns increased from 0.0017 during the pre-announcement period to 0.0070 during the post-announcement period. The cumulative abnormal returns during the post-announcement period were 0.1409.

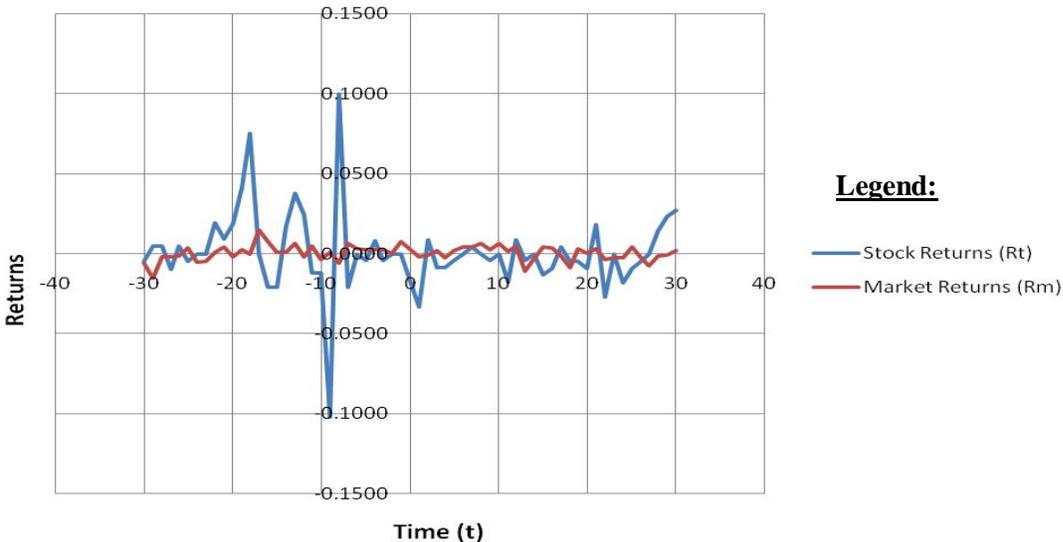
Chart 4.8 Returns for TPS East Africa (Serena) Ltd



4.2.9 Kenya Power & Lighting Ltd (2010)

Findings show a reduction in mean stock returns from 0.0051 during the pre-announcement period to -0.0023 during the post-announcement period. The cumulative abnormal returns during the post-announcement period were -0.2371.

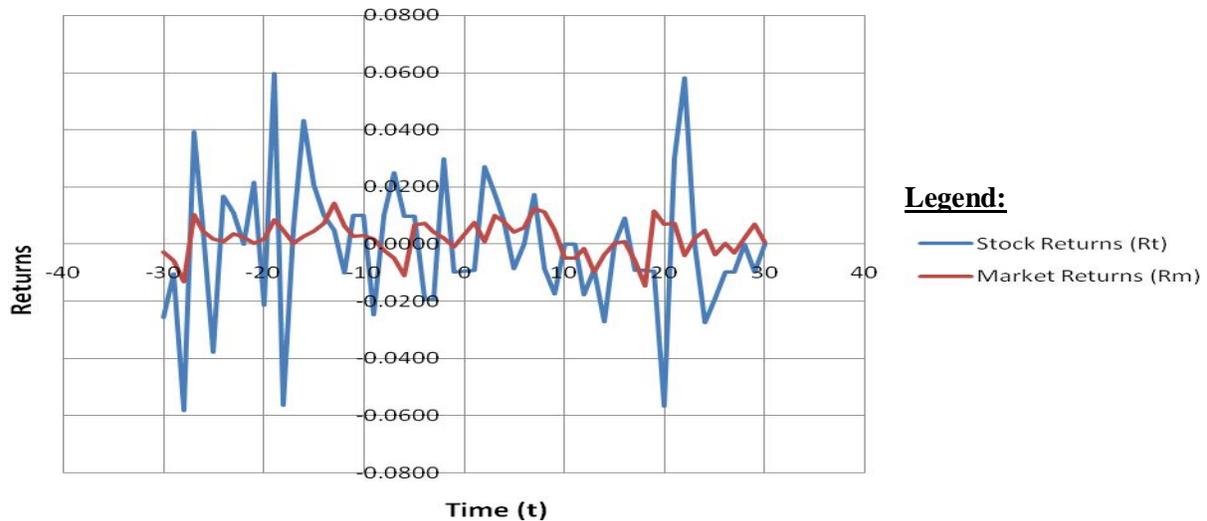
Chart 4.9 Returns for Kenya Power & Lighting Ltd



4.2.10 NIC Bank Ltd (2012)

The mean stock returns of the Bank's shares dropped from -0.0012 during the pre-announcement period to -0.0029 during the post-announcement period. During the post-announcement period, cumulative the cumulative abnormal returns were -0.0424.

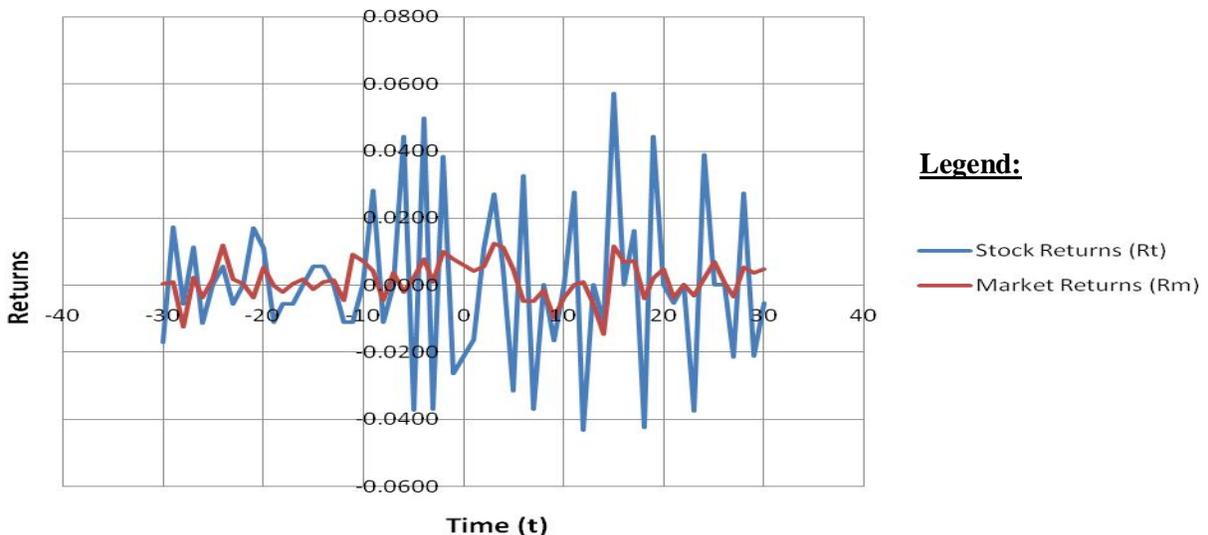
Chart 4.10 Returns for NIC Bank Ltd



4.2.11 Diamond Trust Bank Ltd (2012)

The stock returns of the Bank's shares dropped from a mean of -0.0013 during the pre-announcement period to -0.0000 during the post-announcement period. The cumulative abnormal returns during the post-announcement period were -0.0310.

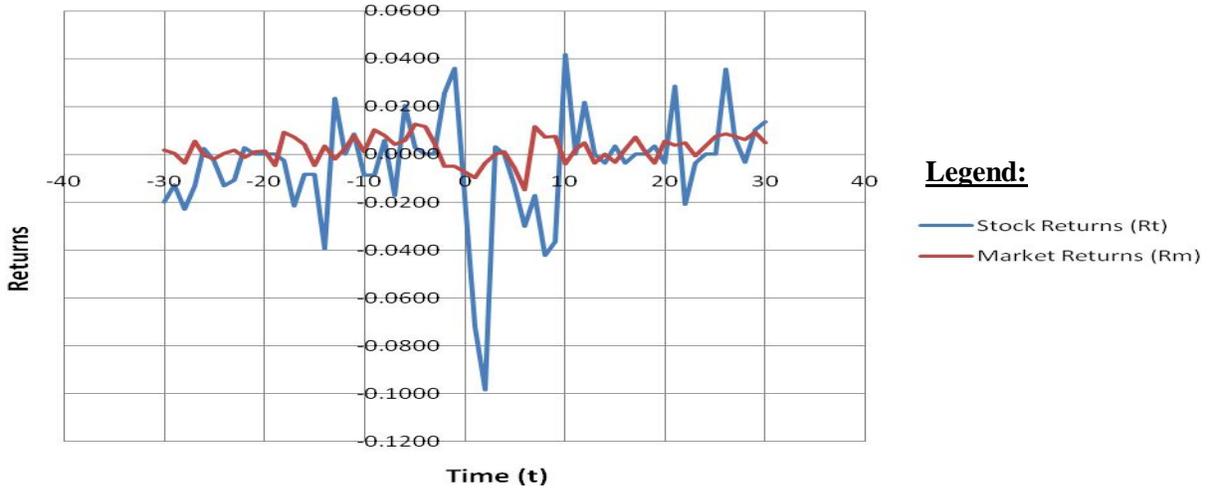
Chart 4.11 Returns for Diamond Trust Bank Ltd



4.2.12 Kenya Airways Ltd (2012)

Findings show that the firm's stock returns reduced from a mean of -0.0027 during the pre-announcement period to -0.0060 during the post-announcement period. The cumulative abnormal returns during the post-announcement period were -0.1088.

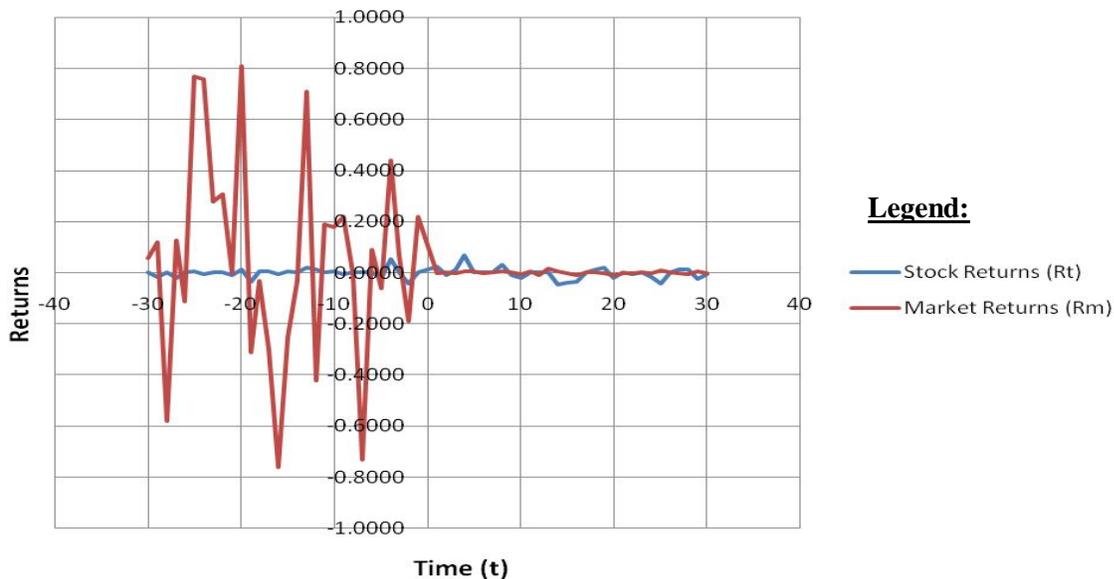
Chart 4.12 Returns for Kenya Airways Ltd



4.2.13 CFC Stanbic Holdings Ltd (2012)

The results show that the mean stock returns reduced from -0.0016 during the pre-announcement period to -0.0031 during the post-announcement period. Cumulative abnormal returns during the post-announcement period were -0.0277.

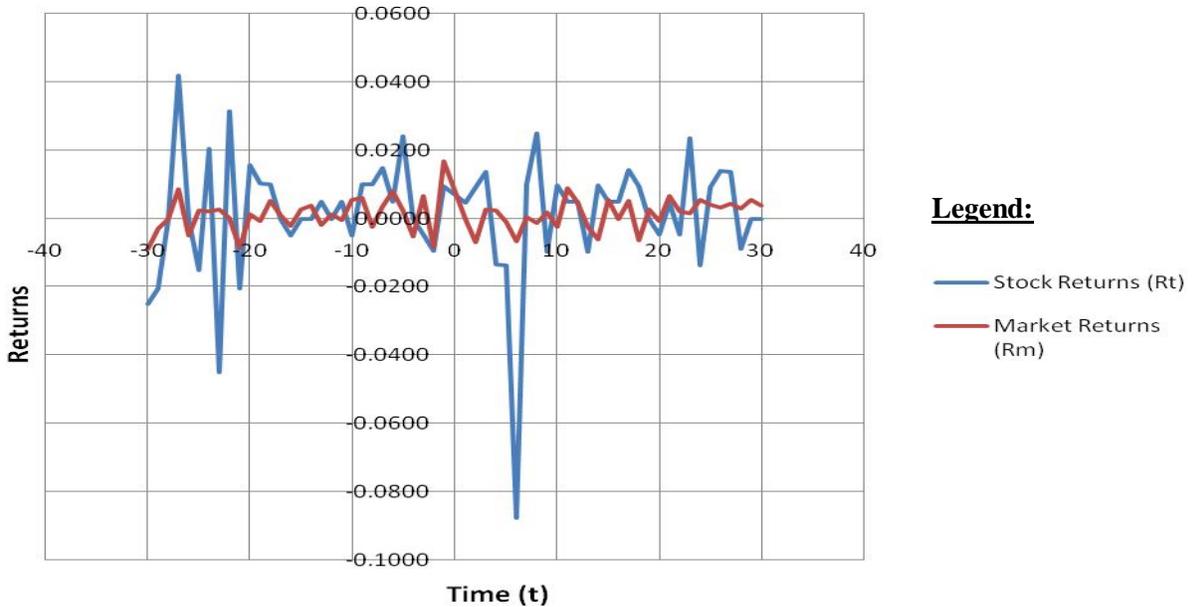
Chart 4.13 Returns for CFC Stanbic Holdings Ltd



4.2.14 Standard Chartered Bank Ltd (2012)

The results show that the mean stock returns reduced from 0.0021 during the pre-announcement period to 0.0008 during the post-announcement period. The cumulative abnormal returns during the post-announcement period were -0.0476.

Chart 4.12 Returns for Standard Chartered Bank Ltd



4.2.15 Summary of Mean Returns for All Firms

The table below shows a summary of the mean stock returns during the event window.

Table 4.1 Means of Stocks Returns

	Firm	Mean Stock Returns			p-value
		Pre-announcement period	Post-announcement period	Change	
1.	DTB (2006)	0.0072	-0.0016	↓	0.1715
2.	Olympia Capital Holdings Ltd (2007)	0.0010	0.0007	↓	0.9781
3.	NIC Bank Ltd (2007)	0.0027	0.0069	↑	0.5603
4.	Diamond Trust Bank (2007)	0.0036	-0.0003	↓	0.3857
5.	HFCK (2008)	0.0083	0.0069	↓	0.9756

6.	KCB (2010)	-0.0032	-0.0045	↓	0.7921
7.	TPS East Africa (Serena) (2010)	0.0017	0.0070	↑	0.5518
8.	Standard Chartered Bank (2010)	0.0063	0.0008	↓	0.0545
9.	KPLC (2010)	0.0051	-0.0023	↓	0.2647
10.	NIC Bank (2012)	-0.0012	-0.0029	↓	0.6931
11.	Diamond Trust Bank (2012)	0.0013	0.0000	↓	0.8253
12.	Kenya Airways (2012)	-0.0027	-0.0060	↓	0.5854
13.	CFC Stanbic Bank (2012)	-0.0016	-0.0031	↓	0.7641
14.	Standard Chartered Bank (2012)	0.0021	0.0008	↓	0.7881

In table 4.1, it can be noted that mean stock returns after the announcement of seasoned equity offerings were lower than the mean stock returns before the announcement of seasoned equity offerings for 12 seasoned equity offerings. This implies there was a reduction in stock returns after the announcement of seasoned equity offerings. Only 2 out of the 14 seasoned equity offerings showed increased mean stock returns in the post-announcement period compared to the pre-announcement period.

4.2.16 Cumulative Abnormal Returns

The regression of market returns and the stock returns enabled the determination of the stocks expected returns during the post-announcement period. From the expected returns, abnormal returns and cumulative abnormal returns were calculated. The results are as shown in table 4.2.

Table 4.2 Abnormal Returns for All Firms

	Firm	Average Abnormal Returns	Cumulative Abnormal Returns
1.	DTB (2006)	-0.0103	-0.3091
2.	Olympian Capital Holdings Ltd (2007)	-0.0021	-0.0635
3.	NIC Bank Ltd (2007)	0.0040	0.1197
4.	Diamond Trust Bank (2007)	-0.0013	-0.0403
5.	HFCK (2008)	-0.0002	-0.0058

6.	KCB (2010)	-0.0003	-0.0003
7.	TPS East Africa (Serena) (2010)	0.0047	0.1409
8.	Standard Chartered Bank (2010)	-0.0055	-0.1661
9.	KPLC (2010)	-0.0079	-0.2371
10.	NIC Bank (2012)	-0.0014	-0.0424
11.	Diamond Trust Bank (2012)	-0.0010	-0.0310
12.	Kenya Airways (2012)	-0.0036	-0.1088
13.	CFC Stanbic Bank (2012)	-0.0009	-0.0277
14.	Standard Chartered Bank (2012)	-0.0016	-0.0476

It can be observed from the results in table 4.2, that all the firms posted non-zero cumulative abnormal returns during the event window period. Cumulative abnormal returns of zero would imply a situation of market efficiency where an investor cannot outperform the market by making abnormal stock returns. The cumulative abnormal returns in this case are non-zero.

4.3 Significance Testing

The differences between the two means (before and after announcement) of each firm were tested for significance using the t-test. The p-values for the tests were as in the table below:

The difference between two means is considered significant when $p < 0.05$. In such a case, the difference between the two means is said to be significant enough and is likely to have been caused by the event under study. The results in the table above show that all the values of p are greater than 0.05. This implies that the difference between the mean returns were not statistically significant. In relation to the study objective, the announcement of seasoned equity offerings did not have a significant effect on the stock returns of the issuing firms.

4.4 Discussion of Findings

In 12 out of the 14 seasoned equity offerings studied, there was observed a decline in the stock returns of the issuing firms. This is demonstrated by the fact that the means of stock returns in the post-announcement period was lower than the means of stock returns in the pre-

announcement period. This means that the announcement of the seasoned equity offerings resulted in a decrease in stock returns for the 12 firms. Only two firms showed an increase in stock returns in the post-announcement period compared to the pre-announcement period. Similarly, 12 out of the 14 firms studied, posted negative cumulative abnormal returns in the post-announcement period compared to only two firms that showed positive cumulative abnormal returns. In the all 14 seasoned equity issues, the cumulative abnormal returns were non-zero. This means there was no perfect market efficiency.

The observed decrease in stock returns after the announcement of seasoned equity offerings was similar to the findings of Frijns, Navissi, Tourani-Rad and Tsai (2006) who found that stock price performance for both the completed and the withdrawn offerings was poor after the announcement. The results were also similar to Shahid, Xinping, Mahmood and Usman (2010) whose study found SEOs price effects to be significantly negative around the event announcement date. With regard to abnormal stock returns, the negative abnormal returns observed in this study contradicted the findings by Gatundu (2007) in which abnormal returns were found to have increased during the event window, although insignificantly.

CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the research findings and underlines the key findings. It also presents the conclusions drawn from the study results as well as making recommendations and suggestions for further study.

5.2 Summary of findings

This study was conducted with the aim of examining the effect of the announcement of seasoned equity offerings on the price performance of stocks. To achieve the study objective, data on share prices and announcements of SEOs of individual firms was collected from the Nairobi Securities Exchange. Stock returns were then regressed against the overall market returns to obtain the regression formula $R_t = a + bR_m$, which explains the relationship between the two variables. The established regression formula was used in each firm case to determine the expected returns in the post-announcement period.

The study results indicate that 86% of the firms studied recorded a decrease in stock returns after the announcement of seasoned equity offerings. Cumulative abnormal returns (CARs) were found to be non-zero. In 12 out of 14 seasoned equity offerings studied, CARs were negative while only two of the cases recorded positive CARs. However, in both cases, the CARs were all close to zero. Significance testing showed that the differences between the means of stock returns between the pre-announcement and post-announcement periods for all the firms under study were not statistically significant.

5.3 Conclusion

From the results, the stock price performance of seasoned equity issuing firms is poor after the announcement of the offerings. The announcement of seasoned equity offerings therefore affects the stock price performance of the issuing firms, even though insignificantly.

5.4 Recommendations

Based on the findings, investors should be cautious when investing in seasoned equity because of the decrease in stock returns after announcement of the offerings. In addition, there is a possibility of the decrease in stock returns becoming significant. On the other hand, seasoned equity issuing firms should plan to address factors that result in the reduction of the stock returns after the announcement of seasoned equity issues with a view to making the issues more attractive to investors.

5.5 Limitations of the study

The study focused on the effect of the announcement of seasoned equity offering on share price and stock returns. However, there are other several factors that affect stock returns that would be of importance to study. Conversely, there are other aspects that announcement of seasoned offerings affect, such as financial performance and growth. Due to time limitation, it was not possible to examine such other factors.

In addition, the data used in this study was collected from the Kenya stock market only whereas other security exchanges in Africa and indeed over the whole world would have been more ideal to enable accurate generalizations on effects of seasoned equity offerings on stock returns. Such expansive research was not intended due to the massive resource requirement.

5.6 Suggestions for Further Research

It would be of interest to expand the study by looking at other factors that affect stock returns, such as dividends announcement, macro-economic factors (including interest rates, inflation), among others. Such a study would involve more than one independent variable. It is also recommended that a similar research be done on a wider scope involving other securities exchanges in the region or in the Africa continent.

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APPENDIX 1

LISTED FIRMS THAT ISSUED SEASONED EQUITY BETWEEN 2004 AND 2013

	FIRM	YEAR OF ISSUE
1.	Kenya Commercial Bank Ltd	2004
2.	Uchumi	2005
3.	CFC Bank	2005
4.	Diamond Trust Bank Kenya Ltd	2006
5.	Olympia Capital Holdings Ltd	2007
6.	Diamond Trust Bank Kenya Ltd	2007
7.	NIC Bank Ltd	2007
8.	Housing Finance Company Ltd	2008
9.	Kenya Commercial Bank Ltd	2008
10.	Kenya Commercial Bank Ltd	2010
11.	TPS Eastern Africa (Serena) Ltd	2010
12.	Standard Chartered Bank Ltd	2010
13.	Kenya Power & Lighting Ltd	2010
14.	Kenya Airways Ltd	2012
15.	Diamond Trust Bank Kenya Ltd	2012
16.	NIC Bank Ltd	2012
17.	CFC Stanbic Holdings Ltd	2012

APPENDIX 2

SEASONED EQUITY OFFERINGS THAT WERE STUDIED

	FIRM	YEAR OF ISSUE
1.	Diamond Trust Bank Kenya Ltd	2006
2.	Olympia Capital Holdings Ltd	2007
3.	Diamond Trust Bank Kenya Ltd	2007
4.	NIC Bank Ltd	2007
5.	Housing Finance Company Ltd	2008
6.	Kenya Commercial Bank Ltd	2008
7.	Kenya Commercial Bank Ltd	2010
8.	TPS Eastern Africa (Serena) Ltd	2010
9.	Standard Chartered Bank Ltd	2010
10.	Kenya Power & Lighting Ltd	2010
11.	Kenya Airways Ltd	2012
12.	Diamond Trust Bank Kenya Ltd	2012
13.	NIC Bank Ltd	2012
14.	CFC Stanbic Holdings Ltd	2012