

**EFFECTS OF STOCK SPLIT AND RIGHTS ISSUES ON SHARE PRICE OF  
COMPANIES LISTED ON THE NAIROBI SECURITIES EXCHANGE.**

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**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE  
REQUIREMENT FOR THE AWARD OF MASTER OF SCIENCE IN FINANCE,  
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## DECLARATION

This research is product of my own work and not the product of anything done in partnership with anyone else. The project has not been previously presented to any other institution. I agree that the research may be accessible for reference and photocopying at the discretion of University of Nairobi.

Signature; .....

Date; .....

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**D63/74108/2014**

The research product has been submitted for examination with my approval as the University Supervisor.

Signature; .....

Date; .....

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## **DEDICATION**

The project is dedicated to my family; particular my wife who encouraged me to start on this noble course and for her unconditional support throughout the research period. Dedication also to my friends and all those who provided the much needed financial and moral support.

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## ABSTRACT

The right issue give current shareholder a choice of buying the firm's new shares which are normally issued at a discount to prevailing market price in order to boost participation in the firm's process of capital generation. This study aimed in identifying effects of rights issue and share split on share prices for listed Kenyan-based companies at the Nairobi Securities Exchange. The target population of this research made up of companies listed at the NSE as at 31<sup>st</sup> December 2014. In total there were 62 companies listed as at December 2014. This targeted all Kenyan based companies that are in the NSE 20 share index and those that had undertaken rights issue and stock split between 2009 and 2014 where the sample was made of 7 companies that have undertaken stock split and 7 companies that have undertaken rights issue between 2009 to 2014. A sheet was generated to collect secondary data on daily closing share prices and stock split pronouncements for a time of 30 days before and 30 days after each rights issue and stock split announcement. The study concludes that the stock price for Kengen decreases before the day of stock split and rights issue and the prices of shares increase gradually after the split and rights issue and that the average market showed both zero and non-zero pre-event returns. However, the zero returns were for less than one day and the remaining days sustained non-zero returns. Further, the study concludes that share price reacted sharply before and after the stock split and rights issue for Uchumi and that a sharp increase in share price was reported 20 days before the stock split and rights issue and a further decrease in stock price after the stock split and rights issue. Further, the study concludes that zero-increase in share price during pre-stock split and rights issue for Mumias. Kenya Commercial bank recorded non-zero price increase for its share in both pre-stock split and rights issue and post stock split and rights issue. This result indicates the stock split and rights issue has no impact on the share price for KCB. In addition, the study concludes that share price for BAT rose steadily during pre-split and rights issue and post-split and rights issue period. The study also concludes that stock split and rights issue has significant effect on share prices for firms listed at the Nairobi Securities Exchange for period from 2009 to 2014.

# CHAPTER ONE

## INTRODUCTION

### 1.1. Background of the Study

Traders consider share splits as high prospective trade opportunities. Traders also see splits as a positive development. Business managers apply share split as marketing and financier tools. Traders recognize the process of stock splits make many shareholders feel better and make them feel that they engender a sense of wealth. The signalling theory states that; splitting companies would receive positive abnormal returns on announcement. A practical test for signalling process that has been studied and found out that there was no registered evidence that split companies experience a temporary rise in percent spread as compared to non-split companies. Fairly priced or under-priced companies will be motivated to take action to reveal information about their true value.

Guo, Liu and Song (2005) studied motives why companies split stock. They quoted the signalling theory and trading- range theory that explain reason behind stock split; According to signalling theory; the firm's managers do declare share split to convey favourable private information about their companies' potential earnings. In splitting their stock, the executive convey to the markets; that raise in earnings and share prices are permanent and not temporary.

Businesses normally announce bonus issue before hand, so that their existing shareholders have a chance to purchase more stocks before other buyers are roped in the process and to allow existing shareholders maintain their proportionate stake in the business, e.g. a corporation whose share is trading at Kshs 20; can decide to announce a bonus issue whereby

shareholders can buy one right for each share held by them, which means shareholders with four rights can buy four new shares at a subscription price of Kshs 19. Directors of the firm are expected to specify to the shareholders when the rights will expire. This is usually anywhere from one to three months from the date of announcement of the rights offering. (Simbovo, 2006).

### **1.1.1 Stock Splits**

A share split happens when a board of directors authorizes a change in the specified value of its share. The reduction in the specified value is made to lower the price of the market of share to make share more attractive to potential investors. When a firm's share splits, the change in the specified value is offset by an equivalent change in the number of shares so the total specified value remains the same. The decision by directors of splitting shares of the firm in order to rise the number of stock which were outstanding at a certain date, thereby issuing more shares to current shareholders. (Dennis, 2002).

Share's price in the market are affected by a share splits. In that during and after the split, share price would decrease since the number of stock outstanding has increased during the entire period. Although, number of outstanding shares and stocks price change but market capitalization remains constant. Fama, Fisher, Jensen and Ross (1969) define stock splits as the trading of company's shares whereby at least five shares are distributed for every four held. Similarly, share splits is a process of increasing the outstanding number of shares through a proportional reduction in par value of the shares, recapitalization achieved by changing the number of outstanding shares. According to Copeland and Weston, (1988), stock splits simply increase in number of outstanding stock without changing any of underlying risks and return characteristics of the firm. Among the firms that are trading in the

NSE that have issued stock splits are; Barclays Bank, CMC, East African Cables Ltd, East African Breweries Ltd, Equity Bank, Centum Investment, Kenya Commercial Bank, Sasini Tea, Kenol, Nation Media Group, Mumias Sugar Company. ([www.nse.co.ke](http://www.nse.co.ke)).

The benefits of stocks split is that, the potential buyers would increase in number because the affordability of each share is improved. The stock will automatically begin to rise in price because of a buying frenzy. Most investors prefer stocks that keep splitting. Some of them conclude it as a company's future prospects. The shortcomings arise if a company splits its stock and then price of the firm itself falls; shares may fall below this requirement and be delisted from the exchange. (Baker and Gallagher, 1980).

### **1.1.2. Right Issue**

The process of right issue is a way listed firm can raise additional capital, Business Daily (28<sup>th</sup> March, 2016). Renneboog (2002) defines a rights issue as, "an option where the existing shareholders can exercise pre-emption rights to purchase further securities in a company in proportion to their holdings". "The (KenGen) board is pleased to confirm that the Government of Kenya has indicated that it takes up its full entitlement in the rights issue representing 70 percent of the transaction through a conversion of some of the loans lent to KenGen into equity (share)" said the firm's company secretary Rebecca miano in a regulatory notice. (Daily Nation, 16<sup>th</sup> May, 2016).

The application value of a share can be put at a discount to the pre-announcement share price of a company. If current investors may not be willing to maintain their proportional equity stake, they may be able to buy or sell provisional allotment letter (The pre-emption right are represented by a renounceable letter).

The broker may sell right that are neither traded nor exercised within stipulated time in market and distribute the proceeds to shareholders. Entitlements renounced before offering (Pre-emption) are commonly positioned with an underwriter or directly with institutional shareholders and are known as *placed firms*. Placing firms' right is only allowed if rights involve represent a predetermined proportion of variation between offer price and theoretical ex-rights price. (Kothare, 1997), (lee and Loughran 1998) and (Brealy and Myers 1997). Among the companies listed in the NSE that have issued Rights issue are; Serena, Diamond Trust Bank, Kenya Commercial Bank, Kenya Airways, CIC insurance, Longhorn Kenya Limited, NIC bank and Kenya Generating Company. ([www.nse.co.ke](http://www.nse.co.ke)).

### **1.1.3 Share Price of Companies**

Share price is the value of one share among the saleable stocks of a firm, derivative. a share price or the price of a company is therefore price of it's future cashflow. The share price of a firm is arrived at during the process of going public, an event called Initial Public Offering (IPO). In IPO, firm may contract an investment firm to analyse and determine the value of the company through the various valuation techniques. They further use these techniques to determine exactly how many shares can be offered to the public and at which price. (Njuru, 2007).

The continuous increase in prices is recognised as an uptrend. Maintained uptrend form a "bull" market while maintained downtrend form a "bear" market., various factors may alter share prices and cause sudden or brief changes in the short and long run. Some of the factors that affect firm's share price include; earnings reports, political events, financial reports and economic news. Not all news in the market affect all securities. (Nyamosi, 2011).

#### **1.1.4. Nairobi Securities Exchange**

Companies in NSE do split their stock and issue rights issue, and this make their share more attractive for individual investors. Nairobi securities exchange which is a market started in 1954 and certified by the CMA and the key obligation is in regulating security market and ensure trading of securities by converging together borrowers and investors at low cost, price at lower post split, do scrutinize lesser section of institutional ownership but scrutinize higher section of individual ownership, after split than before split.

To test if share splitting firms perform better than rest of the market, Lakonishok and Lev (1987) equated their earnings and dividend growth to those of control group. A share split generally occurs in face of new highs for stock. Aduda & Chemarum (2010) post that percentage bid/offer spread rises following a split. By mid of 2013, 13 companies had conducted stock splits. Years 2007 & 2010 had highest split factor 8 of 10 followed by 2004 which had an average split size of 7.5 while 2009 had the lowest at 0.1. However, 2006 had the highest number of splits given that 4 companies conducted stock splits, (NSE, 2014).

Firms that are listed in the securities exchange which have issued rights had been on the rise in recent past. In the year 2004 & 2005, Uchumi and Stanbic holding raised combined right issue of Ksh. 2.01 billion and in the year 2004, The Kenya commercial bank had issued rights amounting to Ksh. 2.75 billion. In the year 2006, DTB issued rights which attracted Ksh. 2.3 billion.

## **1.2 Problem Statement**

In measuring short and long-term performance of share splits, David (1996) of Rice University studied all 1,275 firms whose share split 2-for-1 between 1975 & 1990. He compared share split of similar-sized firms that had not split their stock to one which has split its share. His results on the finding was that the group that had undertaken stock split performed 8% better than the control group that had not undertaken stock split after one year, and 16% better after three years. Share reaction occurring after stock split has fully not been understood and explained.

Extensive application of right offerings has been reported in many nations and also had been published in different research findings. De Jong & Veld (2001) in Netherlands; Gajewski & Ginglinger (1998) in France; Bohren, Eckbo & Michelson (1997) in Norway; Tsangarakis (1996) in Greece; Loderer & Zimmermann (1988) in Switzerland; and Berlund, Liljeblom & Wahlroos(1987) in Finland. Rights offerings are also observed, although not regularly, in Japan (Kang and Stulz, 1996). Armitage (2000), Slovin, Sushka & Lai (2000), it is documented that equity issued in United Kingdom are predominantly rights issues. The stock value reacted negatively in equity issued in various nations.

Most studies outside the United States have found stock prices in other nations generally increase in value across the period near the announcement date of rights issue and are associated with positive abnormal returns. The announcement process and the reaction to equity issued are recorded in Finland, Greece, Japan and Korea. (Renneboog, 2002).

Numerous studies have concluded how markets react to release of share splits. The theoretical studies are found in Dhar & Chaochharia (2008) who researched on the response to share split and right issues in the Indian Stock market. However, it was discovered that a positive average abnormal return would be very substantial. A study on market reaction to share split in the German market was conducted by Wulff, (2002) and discovered that excess returns was registered during the first four days following the split announcement period. Some researches have found that markets behave negatively for instance; Conroy *et al.* (1990) found out that declining trading volume after share splits. Companies which split their share experienced worsening liquidity within first 9 to 12 months as noted by Goyonke *et al.* (2006). Gupta & Kumar (2007) found out that there was no effect on market associated with stock splits.

If a share split is carried out in the market, the total number of shares of the firm may be increased proportionately to the split, but balance sheet items remained the same as it was noted by Wooldridge & Chamber (1983). Alternative research published Evidence regarding the direction extent of the announcement process effect of the rights issues and stock split is varied and analyses of rights issues covering various nations have arrived with inconclusive results. The concept of share splits is fairly recent in Nairobi Securities Exchange with the first split having occurred in the year 2004; as noted by Simbovo (2006). As such, not much study has been done in local market. The inconsistency on the price effect of rights issues and stock split announcements on security prices for different markets makes further research potentially useful to establish the case for Kenya.

This study will examine the behaviour of stock prices in Kenya for the period prior to, during and after the rights issue and stock splits. The study analyses price changes to establish whether share splits announcements elicit any reaction in Kenyan market.

### **1.3. Research Objective**

#### **1.3.1. General Objective**

To investigate effects in stocks split and rights issues on company performance.

#### **Specific Objectives**

- i) To determine why Kenyan markets undertake stock split and rights issue.
- ii) To determine the effects of stock split and rights issues in share prices at Nairobi Securities Exchange.
- iii) To establish the combine effect of right issues and stock splits on company's share price.

### **1.4. Significance of the study**

The research sought to find out how existing shareholders are to benefit from Rights Issue and Stock Splits and how companies in return also benefit from the exchange in the securities market. Investors are able to make better informed investment decisions knowing the effect of issuing a rights issue and stock splits on the company's performance and further assist in the prediction of a company's performance in future.

Although stock splits are seen as just increasing in the number of shares rather than value, this study pursued to find out whether it's just a numerical increase in shares or a real benefit to the company. The finding of this study is to assist researchers and academicians who want to carry out further research in the combined area of rights issue and stock splits.

This study will also be beneficial to companies that are grappling to release stocks splits or rights issue into the exchange market by providing relevant information. It will also provide the basic understanding of relevance of stock splits and rights issue specifically to companies listed in NSE. The management of listed companies can find it useful in making financial decisions particularly when formulating policies on issuance of rights issues and stock splits.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1. Introduction**

The chapter aimed in looking at theoretical and empirical framework of the topic of study from literature studies that have been carried out by various scholars and writers.

#### **2.2 Theoretical Literature Review**

Different models have been proposed and explanatory variables derived to explain reactions of stock splits and rights issues.

##### **2.2.1 Signalling Theory**

In Loderer and Zimmerman (1988) argues; that contribution value at right issues are immaterial because altering contribution cost immediately would change the qualified distribution of price of stock which are selling ex-rights and cum- right. Since non success of rights would be costly, most of the sellers expecting the share price to drop tends to select a low contribution cost relative to present market price. This results to shareholders assuming that the value of the firm from the contribution price.

Brenna & Copeland (1988) presumed; that the firm's managers who had private information about future prospects of their own company and would not release it in the market, so that in the event that a company had some positive prospects and went ahead to splits its share, then the percent spread (bid-ask) will rise for the short term. Markets finally come to observe similar information that managers knew about the company which caused the company's price to rise.

### **2.2.2 Information Asymmetry Theory**

In Miller and Rock (1985), it's implied that; market response to outside investments was negative, and the higher the size of offer which was disclosed a smaller than anticipated present cash flow which establishes the negative information in the market about the current and expected future cash flows. Rights issue can be deduced to be as favourable as news about new investment opportunities. Thereby, right issues are observed to be an indication that the firm had a positive NPV projects which would lead to re-evaluation of the company's shares.

Tsangaris (1996) delivers indication to the assumption that right issues in Greece are observed to be investment prospects. In Norway, market reacted to the industrial information and then it lead to decrease in the size of rights offering as it was noted by Bohren et al. (1997).

### **2.2.3 The Retained Earnings Hypothesis**

It was first proposed by Grinbalatt, Masulis and Jitaman (1984), the retained earnings Hypothesis based in signalling theory. It hypothesizes; that a requirement in a signal to be credible then the market would cause to react to the share split; there would be expenses associated with sending false signal in the market as was noted by Spence (1973). REH is based on the assumption that decrease on retained earnings which result from accounting method chosen in the process of share distribution from debt covenants.

The REH assumes that share distributions accounted in the firm was responsible in reducing retained earnings; where else the more probable signs of managerial optimism are the share distributors who do not reduce retained earnings Crawford et al (2004). A company with the intention of choosing accounting method to be used for its distribution expense would reduce its retained earnings and assumed to have been signalling management's confidence in its future earnings.

#### **2.2.4. Liquidity Hypothesis**

The desire in improving liquidity, motivate the management of a company to splits stock to improve selling of stocks to shareholders by way of restoring prices to a favourable trading range hence liquidity, study by Baker & Powell (1993) reveal that; main motivation for shares split is for an improved liquidity. Companies whose share is constrained liquidity are tempted to choose higher split factor which results in improved liquidity. Dhar et al (2004) examined the shift in clientele around stock split, investors' increases post-split as institutional investors diminish.

Investors expect compensation for illiquid stocks, Acharya and Pedersen(2005) ascertained that liquidity risk disrupt required returns negatively because shareholders pay a premium for assets with higher return in firms of market illiquidity. Amihud (2000) finds that illiquidity attracts a liquid premium and expected stock excess returns differ across period by a function of changes in market illiquidity. Amihud & Mendelson (1986) developed theoretical model that suggests excess return reflect compensation for expected market illiquidity, and the finding explains increases in return variance following stock split. Further, Admati & Pfleiderer (1988) find split not only attracts knowledgeable traders but also noisy traders who react to lesser post split prices hence liquidity.

### **2.2.5 Small Firm Hypothesis**

The theory holds that stock splits, is an attempt by firms to draw attention; under priced firms will get more attraction when they announce splits, Grinblatt et al (1984), the motivation is to draw the prices to more comparable firms in the industry. The splits cause the investors to re-evaluate undervalued company value and incite demand for dormant stock.

On average, there can be a significant rise in a company's stock prices at announcement and that in general, this upward revision of the company's value cannot be attributed to any other period but announcements as noted by Grinblatt, Masulis and Titman (1984). This rise maybe partially due to forecast of imminent rises in cash dividends. Thus, some of information on stock distributions appears to be directly associated to companies future cash flows. Kalay et al (2007) find that share splits are more likely to be motivated by attention the firm draws from retail investors, trading tend to increase around announcement dates and the earning can be explained by the information.

### **2.2.6. Efficient Market Hypothesis**

Investopedia defines E.M.H as investment market whereby it is impossible to beat the history of the market share efficiency because the current share prices would always incorporate and reflect all the market information. What is consistent to market information, reaction has to be instantaneous and unbiased. There are three market reactions on EMH, a market that is consistent with an efficient market, an information pronouncement that can be accompany in a gradual rise of share prices, thereby allowing shareholder report excess returns after announcement.

### **2.3 Determinants of Share Price**

Gupta, Alain & Fran (2008) postulates the causal-effect of the stock price to the interest rate, exchange rate, and share price in Jakarta stock exchange for the period 1993 to 1997 which; can be grouped in sub-periods that is; (January, 1993 to March, 1995, April, 1995 to July, 1997 and August, 1997 to December, 1997). Zagonov, Staikouras and Kalotychou (2007) provide similar results in the study on the UK stock market. That the surplus income is fairly predicted using the publicly available information prior to the ex-split date, stock volatility increases post-split and it is absolutely related to the trading activity. The existence of post-split excess return is rather perplexing since the information is available in advance. The results suggest a strong relationship between trading activities and return volatility over the pre and post splits periods.

### **2.4. Announcement Effects of Rights Issues and Share Splits on Prices**

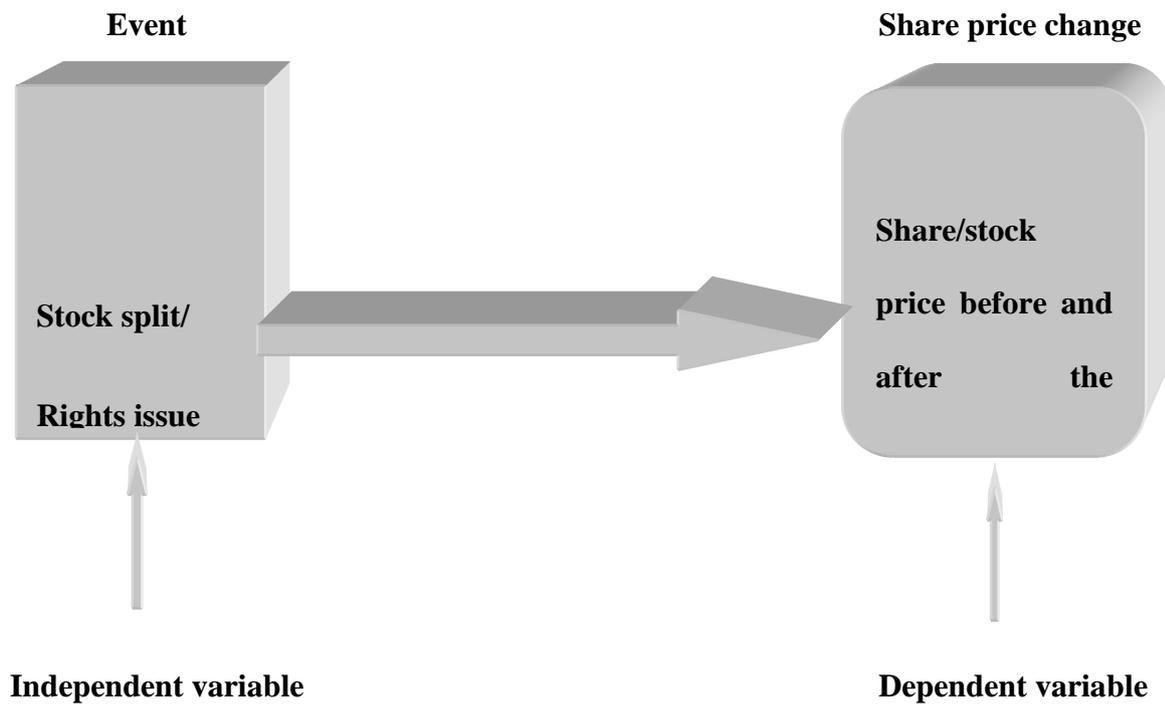
Loderer & Zimmerman (1988) studied the issuance of right issues in Switzerland and found that substantial companies go through positive monthly announcement effect on the share price. Similarly, stock prices which increased considerably higher than the market portfolio returns during the period and around the rights issue pronouncements and had abnormal returns are related with the companies' earnings prospects, changes in financial leverage and stock market surroundings, as studied by Kang, (1990)

Tsangarakis, (1996) examines right issues and attributed irregular share contribution to the positive information conveyed in the rights issue announcement. Rights issue dominate Asian market as well. Gay et al (1992) concludes that among all equity financing, 60.96% occurrence and 76.96% by amount are prepared through rights issues between 1991 and 2000. The listed firms at the China exchange are similar to those of European and Asians nations; they all use right issues to be the only equity financing method to raise funds to satisfy financial obligations.

## **2.5. Conceptual framework**

The Conceptual framework is an essential study technique proposed in assisting a researcher to develop awareness and understanding of situation under scrutiny and to communicate this to the researcher as noted by Kombo & Tromp, (2006).It is very useful in research as it sets the foundation of how concepts are related. It explains in graphs or in narrative form, main dimensions being studied, or the presumed relationships among them. It is derived from theory to identify the concepts included in the complex phenomena and show relationships.

The relationship among the various variables in the study is as depicted below:



**Figure 2.1: Conceptual Framework.**

The above diagram shows the relationship between share price changes, when a firm announces its share splits and the rights issue. Hence, depending on the economic significance of that information, price will rise or fall to a new level. Previous studies indicates that rights issue has relationship with company's share performance, Olesaaya, 2010; Shahid et al., 2010. However, company's share performance and trading volume is also influenced by change in interest rates, inflation rates and government policy and currency fluctuation.

## **2.6 Summary of Literature Review**

From the above empirical studies; there has not been consistency in the research findings on the rights issues and stock splits announcement effect on shareholders wealth. Previous studies indicates that rights issue and stock splits has relationship with company's share

performance, Olesaaya, 2010; Shahid et al., (2010). However, company's share performance and trading volume is also influenced by change in interest rates, inflation rates and government policy and currency fluctuation. Whenever interest rates are low, the borrowing power of investors is increased and this consequently enables them to borrow and purchase the rights issue thereby leading to an improved share performance and high trading volume. When inflation rates are low, the investors can afford to buy additional shares and this consequently leads to improved share performance and high trading volume.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1. Introduction**

This study examined effect of stock split and right issue on share price of firms in order to develop a consistent empirical answer. This was done through an event study in essence a study that is empirical, that examines the behaviour of company performance.

#### **3.2 Research Design**

Under the research design an event study methodology was applied for the purpose of studying the company announcements result. An event study methodology involves the following measure as summarized by MacKinlay, (1997) : (i) Event of interest identification ; (ii) Event window definition; (iii) analysis of companies to be included in the selection sample set; (iv) in the absence of the event a prediction of “normal” return during event window; (v) within the event window estimation of the “abnormal” return and similarly to assess the impact of marketing and advertising relationship such as brand extension on the announcements date. Event study methodology had also been applied to estimate the Cumulative Abnormal Returns (CAR) in lieu of the mean adjusted return model.

#### **3.3. Population**

In this research population of interest for study was the 63 firms in Nairobi Securities Exchange as at August, 2014.

### **3.4 Sample and Sample Design**

According to Saunders et al (2003), a sampling frame is the probability sample. The probability sample in this study is the listed companies that have undertaken stocks splits and rights issue. The criterion in this sampling frame is that they must have undertaken a stock split or a rights issue. The sampling design followed the criteria listed to create a sample for the study. The sample size of the study was 7 companies for stock splits and 7 companies for rights issue.

### **3.5. Data Collection Methods**

The research is based on secondary sources of data collected on rights issues and stock splits at Nairobi Securities Exchange from 2009 to 2014. The financial information was obtained from NSE databases and financial reports.

Other sources of relevant data include Journals, relevant text on stock splits and rights issues , firm's data as well as previous studies done by various scholars which provided a great deal of relevant information.

### **3.6 Data Analysis Methods**

Descriptions was analysed through use of secondary source of data which was presented according to the research problem. The raw figures was then tabulated in tables and charts to explain the movement of stocks splits and rights issue before and after the announcements.

Analysis of data used market model as follows;

The study applied a mean adjusted return model (MAR) to measure Abnormal Returns(AR) on securities in the time of study as depicted below;

$$AR_{it} = R_{it} - (\alpha_i + \beta R_{mt})$$

Where:

$AR_{it}$  = Abnormal Return of stock  $i$  at date  $t$

$R_{it}$  = Actual Return of stock  $i$  at time  $t$

$R_{mt}$  = Market Return

and  $\beta$  = Company's specific constants or parameters from estimation period.

## **CHAPTER FOUR**

### **DATA ANALYSIS AND FINDINGS**

#### **4.1. Introduction**

In the chapter, it does consist of; data analysis, findings and interpretation on data gathered to address the objective of the study. Descriptive statistics and model results were also presented in the chapter.

#### **4.2 Response Rate**

The study targeted a sample size of 7 of the 13 companies that have carried out a stock split at the NSE creating a reply rate of 53.84%. Reply rate was satisfactory to make conclusions for the study. Weisberg, Krosnick & Bowen (1996) recommended; response rating of 70%. As per Mugenda & Mugenda (2003), reply rating of 50% is adequate for study and of reporting the results; a rating of 60% is good and a reply rating of 70% and over is excellent. Similarly, based on the above assertions, then the reply rating was considered to be adequate.

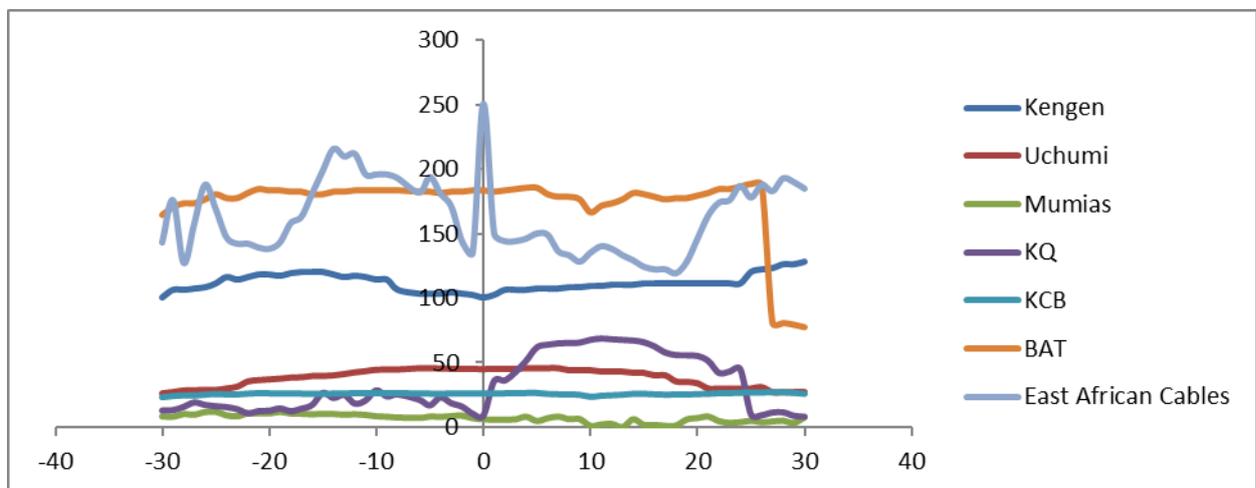
#### **4.3 Findings**

This research made use of daily share price of seven firms which were listed on the Nairobi Securities Exchange and focusing on event window of 61 days consisting of 30 days before and 30 days after the event date. This study was carried out using data of five years on seven selected companies listed at the NSE. The companies analyzed were Kengen, KCB, Mumias, KQ, Uchumi, BAT and East African Cables. It used comparison period approach before and after the stock splits as well as rights issue. The abnormal returns were calculated by subtracting the expected stock price from the daily returns for each of the days after stock splits and right issues.

### 4.3.1 Reaction of Share Price to Stock Split

The purpose of the research was to find out the effect of the share split on share prices. Therefore, the study analyzed the reaction of share price of seven companies following stock split at period  $t_0$  being the day of stock split and pre-stock split is -30 while post-split is +30. Figure 4.1 below illustrates the reaction of share price to stock during and after the stock split window period.

**Figure 4.1: Reaction of Share Price to Stock Split**



As indicated in the graph below, the stock price for Kengen decreases before the day of stock split and the prices of shares increase gradually after the split. The average market showed both zero and non-zero pre-event returns. However, the zero returns were for less than one day and the remaining days sustained non-zero returns. On average, it took the first 3 days for the effect on price to be observed within the 30-day pre-event period.

Share price reacted sharply before and after the stock split for Uchumi. A sharp increase in share price was reported 20 days before the stock split and a further decrease in stock price after stock split. The result indicates zero-increase in share price during pre-stock split Mumias. However, a sharp increase in share price was reported after the stock split.

Kenya Commercial bank recorded non-zero price increase for its share in both pre-stock split and post stock split as shown by the graph above. This result indicates the stock split has no impact on the share price for KCB.

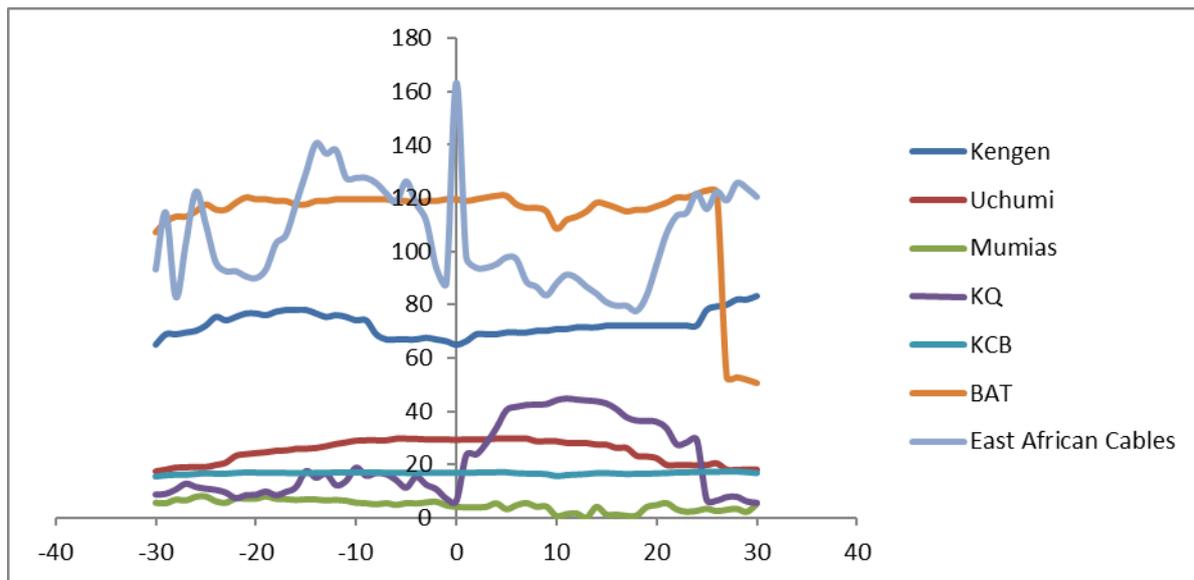
Share price for BAT rose steadily during pre-split and post-split period and showed a decline after  $t+15$ . The absence of price response implies that the information tested has no information content.

The share price for East African Cables is significantly sensitive to both post and pre-stock split event. Sharp decrease in share price is witnessed before  $t_0$  and sudden price increase after the stock split. This is attributed to negative information about the company which causes panic among the investors and traders. Increase in demand for share prices for East African Cables after stock split is attributed the affordability and perceived benefit of the stock traded.

#### **4.3.2 Reaction of Share Price to Rights Issue**

In the above subject and regarding the main aim of the study, was to establish the effect of the rights issue on share prices. Therefore, the study analyzed the reaction of share price of seven companies following stock split at period  $t_0$  being the day of rights issue and pre-rights issue is  $-30$  while post- rights issue is  $+30$ . Figure 4.3 below illustrates the reaction of share price to stock during and after the rights issue window period.

**Figure 4.2: Reaction of Share Price to Rights Issue**



As indicated in the graph above, the stock price for Kengen decreases before the day of rights issues and the prices of shares increase gradually after the split. Between thirty days to four days before rights issues period, there is normal abnormal returns which increased drastically following the rights issues within the first three days. The abnormal returns decrease and returns to normal and stabilizes between twenty four to thirty days after rights issues. Therefore this illustrates that rights issues significantly affects share prices of the Kengen.

Share price reacted sharply before and after the rights issues for Uchumi. A sharp increase in share price was reported 18 days before the rights issues and a further decrease in stock price after the rights issues. After the rights issues day the curve slopes downwards depicting a negative reaction by the stock prices. The result indicates zero-increase in share price during pre- rights issues for Mumias. However, a sharp increase in share price was reported after the rights issues. Similar to effect of stock splits, Kenya Commercial bank recorded non-zero price increase for its share in both pre- rights issues and post rights issues as shown by the graph above. This result indicates the stock split has no impact on the share price for KCB.

Share price for BAT rose steadily during pre- rights issues and post- rights issues period and showed a decline after t+12. The share price for East African Cables is significantly sensitive to both post and pre- rights issues event.

#### 4.4 Test of Significance

##### 4.4.1 Average Abnormal Returns of Stock Split

The t-test statistics was calculated using a 5% level of significance. The tests for significance eliminate the null hypothesis for both pre and post stock split period at 5% level of significance (  $t=3.293$  and  $t=4.980$ ,  $p=0.003, 0.001$   $p<0.05$ ) hence we conclude that stock split has significant effect towards the stock prices for companies listed at Nairobi Securities Exchange for period from 2009 to 2014.

**Table 4.1: Average Abnormal Returns for the stock splits**

	<b>T</b>	<b>df</b>	<b>Sig. (2-tailed)</b>	<b>Mean Difference</b>	<b>95% Confidence Interval of the Difference</b>	
					<b>Lower</b>	<b>Upper</b>
Pre-stock split	3.293	7	.003	.71301	.2702	1.1558
Post-stock split	4.980	7	.001	9.68852	-10.5273	29.9044

##### 4.4.2 Average Abnormal Returns of Rights issue

The t-test statistics was calculated using a 5% level of significance. The tests for significance reject the null hypothesis for both pre and post rights issue period at 5% level of significance (  $t = 1.674$ ,  $P= 0.105$ ,  $P>0.05$ ) hence we conclude that rights issue has significant effect towards the stock prices for companies listed at the Nairobi Securities Exchange for period from 2009 to 2014.

**Table 4.2: Test of Significance for Average Abnormal Returns for rights issue**

	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
Pre- Rights issue	1.674	7	.105	.29109	-.0646	.6468
Post- Rights issue	3.279	7	.026	-.15000	-1.2485	.9485

#### 4.5 Discussion of the Research Findings

In this study; it established that the stock price for Kengen decreases before the day of stock split and rights issue and the prices of shares increase gradually after the split and rights issue. The average market showed both zero and non-zero pre-event returns. However, the zero returns were for less than one day and the remaining days sustained non-zero returns. Share price reacted sharply before and after the stock split and rights issue for Uchumi. A sharp increase in share price was reported 20 days before the stock split and rights issue and a further decrease in stock price after the stock split and rights issue.

The result indicates zero-increase in share price during pre-stock split and rights issue Mumias. However, a sharp increase in share price was reported after the stock split and rights issue. Kenya Commercial bank recorded non-zero price increase for its share in both pre-stock split and rights issue and post stock split and rights issue. This result indicates the stock split and rights issue has no impact on the share price for KCB.

Share price for BAT rose steadily during pre-split and rights issue and post-split and rights issue period and showed a decline after t+15. The absence of price response implies that the information tested has no information content. The share price for East African Cables is

significantly sensitive to both post and pre-stock split and rights issue event. Sharp decrease in share price is witnessed before  $t_0$  and sudden price increase after the stock split and rights issue. This is attributed to negative information about the company which causes panic among the investors and traders. Increase in demand for share prices for East African Cables after stock split and rights issue is attributed the affordability and perceived benefit of the stock traded.

The t-test statistics was calculated using a 5% level of significance. The tests for significance eliminate the null hypothesis for both pre and post stock split and rights issue period at 5% level of significance (  $t=3.293$  and  $t=4.980$ ,  $p=0.003,0.001$   $p<0.05$ ) concluding that stock split and rights issue has major effect towards the share prices of companies listed at Nairobi Securities Exchange for period from 2009 to 2014. The t-test statistics was calculated using a 5% level of significance. The tests for significance reject the null hypothesis for both pre and post rights issue period at 5% level of significance (  $t = 1.674$ ,  $P= 0.105$ ,  $P>0.05$ ) concluding that the rights issue has significant effect at the share prices of companies listed at Nairobi Securities Exchange for period from 2009 to 2014. Similar to the research findings,.

In tandem with the study findings, Wooldridge & Chamber (1983) noted that when a share split process is carried out, it lead to the total number of shares of the firm to increased proportionately to the split, but the balance sheet items remained the same and another research published in 2005 by Oliver Rui, Steven Wang and Tak Yan Leung at the Chinese and City Universities of Hong Kong and Hong Kong Polytechnic University "Although stock splits seem to be purely cosmetic, there is ample empirical evidence that they are associated with abnormal returns. This study analyzes the effect of stock splits using intraday data and

insider trading data in Hong Kong from 1980 to 2000. Consistent with the findings of other countries, we observe positive price reactions in Hong Kong."

## CHAPTER FIVE

### SUMMARY, CONCLUSION AND RECOMMENDATION

#### 5.1. Introduction

Under this chapter, a summary of key data finding and conclusion are drawn from the finding highlighted and recommendation thereof. Conclusion and recommendation drawn here were in pursuit of addressing research objectives of establishing the effect of stock split and rights issue on the share price of the companies listed at the Nairobi Securities Exchange.

#### 5.2. Summary

The aim of the research was to establish the effect of stock split and rights issue on the company share prices at Nairobi Securities Exchange. The study established that the stock price for Kengen decreases before the day of stock split and rights issue and the prices of shares increase gradually after the split and rights issue. The average market showed both zero and non-zero pre-event returns. However, the zero returns were for less than one day and the remaining days sustained non-zero returns. Share price reacted sharply before and after the stock split and rights issue for Uchumi. A sharp increase in share price was reported 20 days before the stock split and rights issue and a further decrease in stock price after the stock split and rights issue.

Further, the study revealed that zero-increase in share price during pre-stock split and rights issue Mumias. However, a sharp increase in share price was reported after the stock split and rights issue. Kenya Commercial bank recorded non-zero price increase for its share in both pre-stock split and rights issue and post stock split and rights issue. This result indicates the stock split and rights issue has no impact on the share price for KCB.

In addition, the study revealed that share price for BAT rose steadily during pre-split and rights issue and post-split and rights issue period and showed a decline after  $t+15$ . The absence of price response implies that the information tested has no information content. The share price for East African Cables is significantly sensitive to both post and pre-stock split and rights issue event. Sharp decrease in share price is witnessed before to and sudden price increase after the stock split and rights issue. This is attributed to negative information about the company which causes panic among the investors and traders. Increase in demand for share prices for East African Cables after stock split and rights issue is attributed the affordability and perceived benefit of the stock traded. It was revealed that stock split and rights issue has significant effect to share prices of companies listed at Nairobi Securities Exchange for period from 2009 to 2014. The t-test statistics was calculated using a 5%, level of significance.

### **5.3 Conclusions**

In this study; I conclude that the stock price for Kengen decreases before the day of stock split and rights issue and the prices of shares increase gradually after the split and rights issue and that the average market showed both zero and non-zero pre-event returns. However, the zero returns were for less than one day and the remaining days sustained non-zero returns. Further, the study concludes that share price reacted sharply before and after the stock split and rights issue for Uchumi and that a sharp increase in share price was reported 20 days before the stock split and rights issue and a further decrease in stock price after the stock split and rights issue.

Further, the study concludes that zero-increase in share price during pre-stock split and rights issue Mumias. Kenya Commercial bank recorded non-zero price increase for its share in both pre-stock split and rights issue and post stock split and rights issue. This result indicates the stock split and rights issue has no impact on the share price for KCB. In addition, the study concludes that share price for BAT rose steadily during pre-split and rights issue and post-split and rights issue period.

The study also concludes that stock split and rights issue has significant effect to share prices of companies listed at Nairobi Securities Exchange for period from 2009 to 2014. The t-test statistics was calculated using a 5% level of significance.

#### **5.4. Recommendations**

The following recommendations are made:-

Future issues which the market will monitor closely are whether there will be a rise in rights issues given that it is a cheaper and sometimes faster means of raising needed capital to boost growth. This arises where an investor sells enough of its tradeable rights to acquire the balance. Institutional investors may start to take this route where they are not prepared to fully support the deals.

For stocks whose prices have gone up to levels where they become expensive for ordinary investors to invest in them, stock split is an activity that should be undertaken to bring such share prices down to affordable levels and for such stocks that are high and unstable, stock splits could be used to stabilize such prices.

Given that rights issues has a positive significant relationship with the share prices, the study recommends that shareholders of companies issuing rights should exercise their rights as this signals a future increase in shareholder value. Majority of companies offering rights use the new capital to build on future earnings or cost saving opportunities.

Investors should be keen enough to monitor the behaviour of stocks and also compare the share performance of various securities in various industries so as to maximize their returns.

Insider trading affects many investors who are not aware and should be declared a crime whereby the government should punish those who engage in it. This should be effected by the Capital Market Authority. This is because insider trading only benefits them selfishly at the expense of the public. Investors should learn more about the securities exchange to avoid making losses and reduce the high costs charged by the financial advisors. This can be done by monitoring the securities even through the media.

### **5.5 Limitation of the study**

The study only covered companies listed at the NSE thus left out those companies that are not listed. Studying more companies both listed and non-listed would have given better representative results than studying only listed companies.

The study took a sample of seven companies that had stock splits and rights issue respectively between 2009 and 2014. If all the companies had been studied, probably the result would be different because the study would be more representative. The study used secondary data which could have been distorted thus not giving accurate information which may have had a negative impact on the final conclusion made from data analysis.

As a student with only three months to carry out this research, time was a major constraint. If the researcher had more time, the researcher would expand the scope of this study to include other variables such liquidity and profitability in the study.

The study also lacked adequate financial resources so as to study the listed companies in Kenya and in the region (East Africa). The researcher therefore studied only those companies listed at the NSE because their information was easily available and would not require resources like travelling costs unlike if i was to travel to get the information at their Securities exchange markets.

#### **5.6 Suggestion for Further Research**

This study used the share prices for periods of 30 days, before and after the stock split and rights issue. A similar study could be conducted and use the stock prices for 120 or 180 days both pre-split and rights issue as well as post-split and rights issue period. This long period may remove some biasness that may influence stock prices following the stock split and rights issue announcements.

A study could be undertaken to establish the relationship between stock splits and rights issue and profitability of firms. Firms that had undertaken stock splits and rights issue were found to have had high share prices. The high share prices could be attributed to good performance of such firms thus they must have recorded good profits. The relationship between profitability and stock split and rights issue could therefore be studied to determine if the profitability of such firms that perform splits and rights issue do continues in future years after the stock splits and rights issue.

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