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CORPORATE ACTIONS ON STOCK RETURNS EMPIRICAL EVIDENCE OF LISTED COMMERCIAL BANKS IN KENYA

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Abstract

This paper probes the dynamic connection of corporate action and stock return of the listed commercial banks in Kenya. An event study research design was used to examine the effect of corporate actions on stock returns of listed commercial banks in Kenya. This method was preferred because it allowed for prudent comparison of the stock returns to an event by looking at abnormal return trends on either side of the event; that is, before and after the event. The target population were all the 12 listed commercial banks at the Nairobi Securities Exchange as end 2020. Secondary data over a period of ten years from 2008 to 2020 was obtained from the Nairobi Securities Exchange and capital market authority financial statements. The study focused on the Capital assets pricing model to check if the firms generated abnormal return. Dividend action, Right action and mergers and acquisition action were examined their variance in terms of abnormal returns was highly examined. The study focused on the computation of abnormal returns on the announcement day (0) 61 days that is, (30 days prior the event and 30 days after the event). The analytical tool used for this research was the Analysis of variance. From the findings, the test statistics value of the F-test in the ANOVA was found to be more than 0.05 for right issues while the F-test for both the dividend action and merger and acquisition action was found to be less than 0.05. This finding led to the acknowledgement of the null hypothesis that, there was no returns change for the banks before and after this Right corporate action were taken by the managers. While significant variations were examined after *dividend action and merger and acquisition had taken place. The interpretation was that right issue does not cause significant changes in stock returns for the listed commercial banks in Kenya while dividend action and merger and acquisition cause significant variations on the stock returns.*

Keywords: Corporate actions, Dividend Action, Right Action, mergers and acquisition action, event widow and abnormal returns

INTRODUCTION

Reactions in the stock returns are the positive or negative changes in value of an investment or asset over time in the stock markets (Kumar & Kasilingam, 2015). These reactions are due to various reasons. One of the main causes for the variations in stock returns is due to the right action (Kumari & Pushpender, 2019). These corporate actions can dictate to the shareholders in a positive way or negative way. On the basis of such, the investors can conclude a judgment on the future performance of the company's shares and stocks (Raz, 2018). A dividend is portion distributed of the company's earnings for a defined earnings period, to equity position holders. Dividend payments are entirely tied to company earnings and therefore have no guaranteed payment that could be quarterly or semi-annually Carlson (2016). Rights issue is a secondary equity issue in which new additional shares are issued to the existing shareholders in exchange for cash (capital) needed by a publicly quoted company, either for expansion purposes or to finance company operations. The rights are issued to the shareholders in the proportion of their existing holdings (Ouma and Ochieng 2015). Yin, & Shanley.(2008), mergers and acquisition are those transaction that are created by the relevant business corporation statutes in the states of incorporation of the parties where parties or business combination whereby two or more companies join to form an entirely new company while an acquisition, when one of the companies bought another both are carried with the intention of financial, strategic and managerial incentives Banks in the securities markets engage in rights issue as a means of generating more capital to finance their expansion plans and to finance internal operations (Kendirli & Elmali, 2016). A rights issue offers an opportunity to the existing shareholders to buy additional securities in a corporation at a discounted price and are allotted based on the number of shares currently held (Kithinji, Oluoch & Mugo, 2014). From a theoretical angle, there are two sets of conflicting theories that try to explain how corporate actions have a positive or negative effects on the stock returns post their implementations. The first school of thought propagated is on the dividends signaling theory (Bustani, Kurniaty & Widyanti, 2021). that a company's announcement of an increase in dividend pay-out is an indication of positive future prospects. Managers with positive investment potential are more likely to signal, while those without such prospects refrain. On the extreme opposing theoretical angle is the random walk theory (Malkiel, 2003) that changes in stock prices have the same distribution and are independent of each other. According to the random walk theory, stocks follow a random and unexpected route, rendering all methods of stock price prediction worthless in the long run.

Statement of the Problem

Companies either in growth or expansion need more capital than they are sometimes able to generate internally. They explore options of raising that additional capital and a corporate actions are such an options (Kithinji, Oluoch and Mugo, 2014).. If the objectives are achieved, they should lead to the improvement of a company's performance and the prices of its listed shares at the stock exchange should go up. The most common types of long-term financing in Kenya include long-term debt, common stock, preferred stock and retained earnings. This implies that companies can use own equity or borrow funds through long-term debt (bonds). Companies use either equity or debt financing but equity is preferred more since it forms a permanent source of funding that cannot be easily redeemed. Listed corporations around the world typically raise external equity capital either from existing shareholders or from new investors. Where corporations raise capital from new investors, it's called an initial public offer (IPO). Here, the public are invited to participate and the formula of allotting shares is clearly stated.

In most cases, corporate actions are offered by closed-end companies. These are companies that redistribute all their earnings failure to which, they face backlash from shareholders who may sell in mass and lower company value (Gowthorpe, 2005).

Corporate actions are many, namely Dividend action, Stock split, Bonus issue, Rights issue and Mergers & acquisitions among others (El Ansary & El-Azab, 2017). At the corporate level, some actions are performed more regularly than others like quarterly, once or once every year. Some other actions are performed very rarely once or twice or may not be announced in the lifetime of a company. These actions can have serious repercussions when it comes to stocks returns. These include Stock splits, Bonus issue, Rights issue, corporate restructure etc. Investors invest the capital in companies in the process of expecting capital appreciation and more returns (Marisetty & Babu, 2017). Corporate actions are one of the major factors which influence the share price movement, so investors eagerly wait for corporate actions to make impact on share-holdings returns (Budi & Ferine, 2022). Dividend action, mergers and acquisitions and Rights issue are the three key of the important corporate actions where most of the investors eagerly wait for dividend announcement to get positive abnormal returns from investment (Muna & Khaddafi, 2022). However these actions may not impact stocks return movement and even when they impact, the impact may create positive or negative abnormal returns.

When a publicly-traded organization gives a corporate action warning, it is starting a procedure that will carry genuine change to its stock return (Hidayati & Putri, 2022). By understanding the various kinds of procedures an investor can in this way have a particular picture of what a corporate action shows about an organization's monetary issues and how that action will impact the organization's offer cost and execution (Rahman, Widagdo & Ambarwati, 2021).

Otieno and Ochieng, (2015), adopts an event study technique on a sample of twelve companies which issued rights between January 1, 2007 and August 31, 2014. The analysis of mean abnormal return revealed that rights issue announcement results into either positive or negative stock return. Based on the cumulative average abnormal return (CAAR), the study concludes that rights issue announcement results into a negative abnormal stock return for the listed firms. Mariko (2016), carried out a study using descriptive research design. Convenient sampling technique was used to identify firms that had rights issue in the period under study. Based on the findings the study found that mean abnormal returns before and after the rights issue announcement was statistically insignificant.

These studies have not been conclusive in their findings on the effect of announcement of corporate actions on the stock returns in Kenya. Its therefore in this regard that this study employs a thorough research to fill the existing gap by conducting, examining the effects of right issue on stock returns among listed commercial banks in Kenya.

General objective

The general objective of this study is to examine corporate action on stock returns empirical on listed commercial banks in Kenya.

1. To determine effects of Dividend action on stock returns of empirical of listed commercial banks in Kenya
2. To determine effects of Right action on stock returns of empirical of listed commercial banks In Kenya.
3. To examine effects of Mergers and acquisition on stock returns empirical of listed commercial banks in Kenya

LITERATURE REVIEW

Felimban, Floros and Nguyen (2018) investigated the stock market response to dividend announcements in high growth emerging markets of Gulf countries. The sample includes 1,092 dividend announcements from 299 listed firms over the period 2010-2015. The findings indicated that in the environment where there is an absence of capital gain and income tax, the authors find some evidence for the stock price reaction that partly supports the signaling hypothesis. The findings show that the Gulf Cooperation Council (GCC) market is inefficient because of the leakage information before the announcement in bad news, and the delay of share price adjustment in good news. In addition, the authors report significant trading volume (TV) reaction in all the three announcements' clusters, where dividends increase, decrease, and are constant, lending support to the hypothesis that the dividend change announcements have an impact on the TV response due to different investors' preferences. This is the first empirical paper on market reaction in share price and TV around dividend announcement using data for the majority of GCC countries.

Mehrotra & Sahay (2018), examined the impact of mergers and acquisitions on operating performance in several Indian businesses was investigated. The research was based on a sample of 118 public limited firms and publicly traded companies from 1991 to 2003. The data from annual published financial reports was analyzed using financial ratios in terms of profitability and return on investment. Varied industries produced different findings, according to the study. After the merger, financial performance in the banking and finance industries improved, whereas financial performance in the chemical, pharmaceutical, textile, and electrical industries declined significantly.

Moctar & Xiaofang (2014) studied the influence of mergers and acquisitions on commercial bank financial performance in West Africa. Two sets of banks that experienced mergers and acquisitions in the West African economic community were chosen for their case study sample size. Annual financial statements were used to collect secondary data, which was then examined using financial ratios. M&As were found to have a detrimental impact on financial performance. Furthermore, the analysis demonstrated that short-term financial performance could not be accomplished.

Rights issues give existing shareholders the option of purchasing new shares, normally issued at a discount to the prevailing market price in order to encourage participation in the capital raised over purchasing shares in the market (Kithinji, Oluoch and Mugo, (2014). Otieno and Ochieng (2015), investigates the effect of rights issue announcement on stock returns of companies listed at an organized exchange. The study adopts an event study technique on a sample of twelve companies which issued rights between January 1, 2007 and August 31,

2014. The study establishes that stock prices and returns changes significantly in the post announcement period than in the preannouncement period. Ogada (2014), adopted an event study methodology which attempted to establish the information content of rights issue on share returns. The population of the study was 18 companies listed in the NSE. Secondary data collected spans 7 years from 2005-2012; share prices for 30 days before the announcement of rights issue and 30 days after the announcement date was used to generate actual returns, expected returns and abnormal returns. T-test analysis was used to test whether there was significant difference on returns between the two periods before and after announcement date. The results led to the conclusion that the expected returns as well as the market returns were significantly higher after rights issue than before rights issue. However, abnormal returns were not significantly different implying that the information content of rights issues do not affect stock return and this may be an indicator of market efficiency. Dewi and Candraningrat (2019), aims to empirically explain the differences in abnormal returns before and after the announcement of the rights issue and to determine the form of capital market efficiency in Indonesia. Data are collected from 27 listed companies in the Indonesia Stock Exchange (IDX) that conducted a rights issue in 2014-2018. The data analysis technique used is the Kolmogorov-Smirnov Normality Test and the Parametric Statistical Test with a paired sample t-test. Based on the results of hypothesis testing not found differences in abnormal returns both before and after the announcement date indicating the market does not react to the right issue event.

METHODOLOGY

In the spirit of achieving the set objectives, only secondary data obtained from the Nairobi Securities Exchange and capital market authority was relied upon in this study. The data obtained from the audited financial statement of the quoted companies was compared with the documentation of the Nairobi Securities Exchange to ensure correctness in data collection. The study therefore involves the use of secondary data collected from the commercial banks financial statements for the period of ten years from 2008 to 2020. The data was obtained from the audited financial statement of the quoted companies was compared with the documentation of the Nairobi Securities Exchange to ensure correctness in data collection. The study therefore involves the use of secondary data collected from the commercial banks financial statements for the period of ten years from 2008 to 2020.

Event Study- Market Model Specification

This study employed standard event methodology to compute corporate action on stock returns. The first step in measuring a corporate Event entail defining the event period. The event is centered on the announcement date usually designated as date zero in the event time. The purpose of an event study is to capture all the effects on stock price. Longer periods were used to make sure that all the effects of the events were captured; this subjected the abnormal return and Cumulative returns.

The following process of analysis was adopted

Step 1 Identify the occurrence day of the event Corporate Action

The first step is to identify the event to be examined, and after that gather information of listed commercial banks that had experienced such as Dividend action, merger and acquisition and Right Action. The information required to the declaration date, the stock prices of the firm when the event occurred

Step 2 Identification of Event Windows

This involves the collection of stock prices within the event window

Step 3 Determination of the Daily returns and Abnormal returns

Step 4 Computation of the Average Abnormal return and the Cumulative abnormal returns

Analytical Model

The study focused on the capital asset pricing model to check if the firms generated abnormal return. The first step was to identify the event to be examined, and after that gather information of listed commercial banks that had experienced such a specific corporate action. The information required incorporate the declaration date, the stock prices of the firm when the event occurred. The second step was the value estimation step. Moreover, we should settle on a time over which the stock returns of the engaged firm will be inspected. This is was the occasion window. A post event time that is short not have the capacity to show the full financial impacts while a post event period that is too long not precise as it may incorporate impacts of different occasions happening in a similar period. In step three abnormal return were calculated using a reorganized CAPM model. The study focused on the computation of the announcement day (0), 61 days (30 days prior the event and 30 days after the event), calculation of daily returns for each of the company as follows;

Stock Returns

$Rjt=aj +bjRmt+\mu$

Where; Rj is the Return On Stock j on day t

Aj and bj are the intercepts and the slope of the linear relationship between the returns of stock j and Returns of the overall market. Rmtis the return on the market index on the day t.

Calculation of the abnormal Return as follow

Abnormal Return (AR) = $Rjt – aj – bjRmt$

RESULTS

Table 1: Dividend issue action on stock returns of listed of commercial banks in Kenya

Test for Equality of Means of Divided Action Categorized by values of Category, Sample: 1 61, Included observations: 61				
Method		df	Value	Probability
ANOVA F-test		(2, 58)	10.78700	0.0001
Analysis of Variance				
Source of Variation		df	Sum of Sq.	Mean Sq.
Between		2	0.029693	0.014847
Within		58	0.079828	0.001376
Total		60	0.109522	0.001825
Category Statistics				
Category	Count	Mean	Std. Dev.	Std. Err. of Mean
Due day	1	0.021430	NA	NA
Days before	30	-0.023110	0.005062	0.000924
Days after	30	0.021008	0.052221	0.009534
All	61	-0.000683	0.042724	0.005470

The significance value of the F test in the ANOVA table is more than 0.05. Thus, study did must not reject the hypothesis that means of abnormal returns are equal across the two categories (before and after). The means also show no major variations across the three categories. Before right issue the mean is negative and after issue it was found to be positive. However, the ANOVA F-test statistic value of 10.78700 and the associated insignificant p-value of 0.0001 show that there is a significant variations before and after Dividends action issue. This is an indicator of significant reaction

Table 2: Merger and Acquisition issue action on stock returns of listed of commercial banks in Kenya

Test for Equality of Means of AARALL, Categorized by values of Category, Sample: 1 31, Included observations: 31				
Method		df	Value	Probability
ANOVA F-test		(2, 28)	35.71742	0.0000
Analysis of Variance				
Source of Variation		df	Sum of Sq.	Mean Sq.
Between		2	0.052452	0.026226
Within		28	0.020559	0.000734
Total		30	0.073011	0.002434
Category Statistics				
Category	Count	Mean	Std. Dev.	Std. Err. of Mean
Due day	1	-0.127117	NA	NA
Days before	15	-0.023141	0.037347	0.009643
Days after	15	-0.103571	0.008587	0.002217
All	31	-0.065413	0.049333	0.008860

The significance value of the F test in the ANOVA table is more than 0.05. Thus, study did must not reject the hypothesis that means of abnormal returns are equal across the two categories (before and after). The means also show no major variations across the three categories. Before right issue the mean is negative and after issue it was found to be positive. However, the ANOVA F-test statistic value of 35.71742 and the associated insignificant p-value of 0.0000 show that there is a significant variations before and after right issue. This is an indicator of significant reaction.

Table 3: Right Issue Action On Stock Returns Of Listed Of Commercial Banks In Kenya

Test for Equality of Means of abnormal returns, Categorized by values of category, Sample: 1 61, Included observations: 61				
Method		df	Value	Probability
ANOVA F-test		(2, 58)	0.061925	0.9400
Analysis of Variance				
Source of Variation		df	Sum of Sq.	Mean Sq.
Between		2	0.073636	0.036818
Within		58	34.48440	0.594559
Total		60	34.55803	0.575967
Category Statistics				
Category	Count	Mean	Std. Dev.	Std. Err. of Mean
Due day	1	0.132450	NA	NA
Days before	30	-0.032701	0.091937	0.016785
Days after	30	0.028291	1.086584	0.198382
All	61	2.30E-06	0.758925	0.097170

The significance value of the F test in the ANOVA table is more than 0.05. Thus, study did must not reject the hypothesis that means of abnormal returns are equal across the two categories (before and after). The means also show no major variations across the three categories. Before right issue the mean is negative and after issue it was found to be positive. However, the ANOVA F-test statistic value of 0.061925 and the associated insignificant p-value of 0.9400 show that there is no significant variations before and after right issue. This is an indicator of insignificant reaction.

CONCLUSIONS AND DISCUSSION

The general objective of this study was to examine on corporate actions on stock returns empirical evidence of listed commercial banks in Kenya. This study found that, the listed commercial banks should consider the role of right issue on stock returns. The findings show that there is a significance reaction of dividend action and mergers and Acquisitions with a p value of the F-test was less than 0.05 while for the right issue the findings show that there is an insignificance since the p-value of the F-test in the ANOVA table for cumulative right issue action since it was found to be is more than 0.05. Thus, null hypothesis that means of cumulative returns were equal across the three study period categories (before, due day and after) was rejected. The means also show no major variations across the three categories. Before right issue the mean is negative, during issue day the mean is positive and after issue it was found to be positive. This is an indicator of insignificant reaction when the value of F-statistic was investigated.

The significance value of the F test in the ANOVA analysis for divided action table was found to be less than 0.05. Thus, the study rejected the null hypothesis that means of AARALL were equal across even for the three categories (before payout, during pay- out day and after payout) for banks for the duration of study 2009 to 2020. The means also show major variations across the three categories. Before divided paid the mean was negative, during issue day the mean was positive and after pay out it was found to be negative. This is an indicator of a significant reaction

The test of equality on merger and acquisition revealed that the means were variable across stocks and the three test periods (before, due day and after) as well. The two test F-statistics ANOVA F-test and Welch F-test* were significant thus providing strong evidence of the rejecting of the null hypothesis of equality of means for all banks. Every bank's abnormal return had their own means and standard deviation. This indicated that there were significant abnormal variations due to the merger action taken and the effect was felt differently across stocks markets. The means for the right issue show no variations across the three categories. This is an indicator of insignificant reaction on the over all. These results for the right issue are homogeneous for all the banks when they are considered together this implies that investors react to stock prices uniformly when it comes to the right issue. This study has noted that Right Issue Action at the Nairobi securities exchange does not precipitate reaction on the stocks returns. The implication is that investors do not regard it as a market signal to the prices thus ignore it when making investment decisions.

SCOPE FOR FURTHER RESEARCH

This study was only limited to listed commercial banks in Kenya. The study suggests further research on the relationship between divided pay out, right issue and mergers and acquisitions and stock returns of listed commercial banks in other regions like the East Africa Community region. Further research should also be directed to other listed companies since this study concentrated only on the listed commercial banks in Kenya. The study recommends the considerations of other managerial action variables such as stock split and stock consolidation

Action, Buyback Action variables to be able to assess their effect on the stocks returns in Kenya.

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