INTRODUCTION

1.1 Introduction

Capital market is the market for the buying and selling of long-term financial instruments, such financial instruments include; ordinary shares, preference shares, bonds, mortgages. In capital market listed or unlisted companies can use many different types of corporate actions to raise funds, which in turn effect the liquidity and price of their shares in the market. There are various methods that a company can use to raise equity finance, some of such methods include obtaining lists on the stock market and selling some of its shares to the general public, other methods may include placing and bought deal. If the company is not yet listed on a stock exchange, the company can prepare for an initial public offering (IPO), in which it will be valued and an opening price will be set for its shares when they are released on the market. How much finance can be raised through an IPO depends partly on the perceived value and the share price of the company and partly on how much interest there is in the shares when that are released on the market.

For a company that is already listed on an exchange, an alternative route is to launch an additional share issue (also known as a seasoned equity offering, or SEO) or a rights issue. Right shares are those shares which are issued to existing shareholders. According to section 81 of Indian Company Act 1956, “Company can issue right shares only after the two years of creation of company or one year of first issue of shares whichever is earlier.”

A SEO is a new equity issue by a company following its IPO. A rights issue is an invitation to current shareholders to purchase additional new shares in a
company. This type of issue gives the right to existing shareholders to purchase new shares, generally at a discount on the current market price on a future date. Therefore the company is giving an opportunity to shareholders to increase their holding at a discounted price. Companies may use rights issues to raise cash as an alternative to bank financing, funding acquisitions and paying down debt in order to finance future growth. For reassurance that it will raise the required finance, a company may have its rights issue underwritten by an investment bank, which would take delivery of all stock that was not taken up with the issue. Renounceable rights are rights offered by a company to existing stockholders to purchase further stock, usually at a discount. These rights have a value and can be traded. If rights are to be issued, the company has to set the price of the new shares, determine how much it will sell, and assess how the current share value will be affected as well as the effect on new and existing stockholders. Non-renounceable rights are not transferable and cannot be bought or sold, these rights must be taken up or that will be lapsed.

**The Reasons for a Company Raising Right Issue:**

There may be various reasons why firms may wish to raise a right issue, and such reasons will vary from one company to another company. Some of such reasons include:

- To raise additional funds for capital investments
- To raise more funds for an acquisition or mergers
- To reduce a company’s debt or to pay off some of a company’s debt when it falls due (it will reduce its debt and will increase its equity, it will eventually reduce the company’s gearing)
- To increase a company’s cash reserves for precautionary purpose (especially in the global financial crisis and economic uncertainties)
Benefits of Issuing Right Shares:

➢ More control on existing shareholders
➢ No loss to existing shareholders
➢ No cost for issuing shares to public
➢ Helpful to increase the goodwill of the company
➢ Capital formation

Disadvantages of Issuing Right Shares:

➢ The main disadvantage of issuing shares through an IPO is that a company’s owners no longer have full control on the business and become accountable to stockholders. Stockholders can block plans if they believe that there is risk to their investment.
➢ Any issuance of further shares dilutes the holdings of existing stockholders as a proportion of the company’s total shares. This can lead to dissatisfaction among the minority stockholders. Stockholders who do not have pre-emptive rights are most at risk of seeing their investment diluted.

Choice before Shareholder In Respect of Right Shares:

Right issue as the name suggest is a right to buy more ordinary shares in the company as an existing shareholder, though it is a right, but it is not an obligation, this means existing shareholders do not need to take up the right (shares) especially when the share price dips lower than the right issue price by the time the chair needs to be taken up.

There are broadly four main options available to existing shareholder such as:

i) **Subscribe to the rights issue in full**

   Effect on shareholder wealth- No change in the wealth of shareholders
ii) **Ignore your rights/take no action**
   Effect on shareholder wealth - Decrease in wealth

iii) **Sell the rights to someone else**
   Effect on shareholder wealth - No change in the wealth of shareholders

iv) **Subscribe to the rights in part & for balance sell the right**
   Effect on shareholder wealth - No change in the wealth of shareholders

1.2 **Origin of the Research Problem**

The proposed study seeks to examine right issue by Indian companies listed on a stock exchange after liberalization of Indian economy in the year 1991. It attempts to test some popularly held belief about the effects of right issues on share prices of the Indian companies. The study centres on certain key questions such as the following: Are right issues preceded by an increase in share prices or vice-versa? Is there any significant relationship between right issue and cum/ex-right issue share price changes? Is there any significant relationship between right issue and earning per share of the companies? Is there any difference between right issue guidelines issued by the CCI (Ministry of Company Affairs) and SEBI? All these questions have immense academic value to the students and researchers of corporate finance.

1.3 **Objectives of the Study**

The main objective of the study is to examine the following issues which are given below:

- To examine the overall trend of right issues by Indian companies after liberalization period;
- To examine the effect of right issues on share prices of the companies;
- To examine the impact of right issue on Earning Per Share (EPS) of companies
1.4 Scope of the study

The present study covers about 24 years period of the study and it also include the impact of right issue on share prices, and Earning Per Share (EPS). So, the study will be very much relevance for those companies that wants to issue right share. Besides, its academic significance, the proposed study is likely to provide practical insights into the true nature purpose and effects of right issues, which may hopefully help corporate management, investors and policy makers in their decision-making.

1.5 Significance of the Study

The rights issue is a way for companies to raise capital. Capital is raised when investors pay for the new shares that are being issued. Companies can use the raised capital to acquire assets, make a takeover, repay debts or save themselves from bankruptcies. Of course, a company can raise capital by other ways, such as borrowing from banks or issuing bonds. However, there can be times where the bank may be reluctant to lend, especially if the company is not doing well. In addition, higher interest rate incurred by loans or the issuance of bonds may also force a company to raise capital through the rights issue offering.

This study helps to examine the overall trend of right issues by Indian companies after liberalization period. It also analyzes the frequency of right issues made by the same company during the period of study. The time interval between two successive right issues is also presented in this study. The study also incorporates the effect of right issues on share prices and Earning Per Share (EPS) of the companies. The study anticipates proposing some insight for Indian policy makers, shareholders and portfolio managers. Thus the study adds to the body of knowledge and existing effort of research fraternity in analyzing the impact of right
issue on Indian stock market in the changing pace of development. Besides, its academic significance, the proposed study is likely to provide practical insights into the true nature, purpose and effects on the right issues, which may hopefully help corporate management, investors and policy makers in their decision-making.

1.6 Hypotheses of the Study

In line with the objectives stated above, the following hypotheses has been formulated and tested for the purpose of this study:

H₀₁: there exists no difference between the pre and post average returns

H₀₂: there exists no impact of right issue on Earning Per Share (EPS)

1.7 Research Methodology

1.7.1 Period of the Study: The present study covers right issues made during 1991-2014 by the Indian Companies both from the public sector as well as the private sectors.

1.7.2 Types of Data: The present study is analytical in nature and it is based on secondary data. The present study covers the right issue made during 1991-2014 by the Indian companies both from the public as well the private sectors listed on a stock exchange. The sample of listed Indian companies will be selected on the various basis, such as a size of the companies, age of the companies, frequency of right issues, ratio of the right issues, time lag between two right issues etc. Thus the study incorporates the data of the S & P CNX 100 listed on the National Stock Exchange was considered for the analysis.

1.7.3 Scope of the Study: The present study covers about 24 years period of the study and it also includes the impact of right issue on share prices, and Earning Per Share (EPS). So, the study is much relevant for those companies
that want to issue right share. Besides, its academic significance, the proposed study is likely to provide practical insights into the true nature, purpose and effects of the right issues, which may prove helpful for corporate management, investors and policy makers in their decision-making.

1.7.4 **Sources of Data:** The sources of data for the study has been collected from the publication of stock Exchanges, BSE, NSE official websites, SEBI Bulletins and other publications, Ministry of Company Affairs (Publications-Company News & Notes) and RBI Bulletins.

1.7.5 **Methods of Data Analysis:**

- The study incorporates the use of descriptive statistics that includes minimum, maximum, mean, median, standard deviation, skewness and kurtosis.
- The Shapiro-Wilk Test is employed with an objective to ascertain the normality of the data.
- The Independent sample t-test has been applied to examine the effect of right issue on share prices of the companies.
- Karl Pearson Coefficient of Correlation to examine the measure changes in earning per share with right issue.

1.8 **Outline of the Study**

The entire study has been divided into seven chapters, each deal with a specific spectrum of the whole research work.

**Chapter 1** deals with the introduction and highlights the rationale behind the study. It brings the significance and objectives of the study. It explains data source and time period of the study. It outlines the methodology to be adopted and limitations of the present study.
Chapter 2 discusses the review of related earlier studies available in the literature. All the studies are divided into two parts including international and Indian studies in this context.

Chapter 3 opens up with a description of the nature of right shares and their theoretical background. It also deals with rules & regulations relating to right shares issues in India.

Chapter 4 discusses the characteristic feature of right issue made in India during 1991-2014. This is an empirical retrospect of right issues in India.

Chapter 5 relates to the results obtained from empirical exercise done with respect to impact on the share price due to the right issue.

Chapter 6 accommodates the impact of right share issue on Earning Per Share (EPS)

Chapter 7 summarizes the findings, provides conclusions and draw suggestions from the present study and provide scope for further studies.

1.9 Limitations of the Study

Even though every possible effort has been made to make this research authentic and comprehensive, however many constraints were also at play. The limitation of the study comprises of the following.

➢ The present study is based on the secondary data published by BSE, NSE, SEBI and various publications. Homogeneity in the published data is not found in all cases. Even data published by the same organization vary, every possible effort has been made to comprise reliable data for those years where difference has been found by considering SEBI publications as a base.

➢ The study is mainly based on the data of BSE and NSE only.
➢ The data considered are generally monthly or yearly as the period of study is quite long and daily based data would have been large to maintain.

➢ It is noted that there were few companies available in this study that has not been categorized according to the BSE classification. So that companies were kept under other companies.

➢ The data of the S & P CNX 100 listed on the National Stock Exchange as of 16/09/2015 were considered in the analysis. Out of these 100 companies only 29 companies were found to have made a right issue. Out of which 29 companies, there was no record found of Crompton Greaves Ltd (Electric Equipment Sector), Reliance Capital Ltd (Finance Sector), and Zee Entertainment Enterprises Ltd (Media & Entertainment Sector) as on 30/09/1993, 24/11/1994 and 30/09/1993 respectively. So for the analysis purpose only, 26 companies have been considered.
References


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