Rights issue as a means of raising additional capital for listed companies

Companies often find themselves in need of additional capital to fund expansion into new markets, adoption of new technologies, investment in research, debt repayment, fund working capital, acquisitions or even to implement a turnaround strategy. While in many cases companies use profits or retained earnings from ongoing operations to fund such activities, at times companies go for external sources for more than one reason.

This is usually in the form of debt capital or equity capital. The former refers to bank loans or corporate bonds. When seeking to boost their capital through borrowing, companies usually have to bear in mind that the principal amount and interest must be paid to lenders within a specified period, failure to which can lead to liquidation of the company by the lenders.

Equity capital on the other hand refers to funds raised by either sale of shares by existing owners or issue of new shares by the companies seeking additional equity. A rights issue is one of the ways through which companies raise equity capital without the conditions usually tied to debt capital.

Rights issues provide existing shareholders with an opportunity to purchase additional new shares from the company. This type of issue gives existing shareholders the right to purchase additional shares at a prescribed price on a stated future date. The additional shares are usually sold by the company at a discount to the market price.

Legally, a rights issue must first be offered to existing shareholders before being offered to non-shareholders. This is because existing shareholders have the “right of first refusal” otherwise known as “preemptive rights” on the new shares. By taking these preemptive rights up, existing shareholders can maintain their existing percentage holding in the company.

While the rights issue approach is mostly taken by companies seeking additional capital to meet future financial obligations, not all companies that pursue a rights offering are in financial trouble. From the Kenyan experience, most companies opt for this route as a way of reducing their debt to equity ratio which then makes it easier for them to regularize debt and access new working capital facilities to fund their expansion or turnaround strategies. This in many cases results in capital gains for the investors in the long run.

In 2016 when KenGen floated its rights issue, the shares were trading in the NSE at KES 8.00. The rights issue gave investors an 18.36% discount allowing them to acquire additional shares at KES 6.55. This could have been seen as a steep discount by some quarters. Today the shares are trading at about KES 34.00; more than four times what they were exchanging hands for at the time of the rights issue.

NIC Bank (now NCBA) twice went the rights issue way to fund its restructuring which included rebranding and eventually rising to become one of the top five banks in the country. Diamond Trust Bank, Stanbic Bank, Standard Chartered Bank and Housing Finance Corporation are some of the other institutions that have had successful rights issues that resulted in growth for shareholders.

Companies are required to furnish the Capital Markets Authority (CMA) with their information memorandum when seeking approval. This includes historical financial accounts that have been reviewed by an audit firm, which ensures that the company is giving investors a true perspective of history. CMA also looks at how the company intends to utilize the funds raised by the rights issue and what impact that is going to have on its topline. There is also due diligence conducted by independent lawyers to ensure that there are no legal issues that may adversely affect the company’s financial health.

While most of the Kenyan rights issues have been successful, in many of the cases not all shareholders usually take up their rights – in most cases due to lack of proper information on how this could lead to them increasing the value of their investment.

It is however encouraging to note that even though this is an avenue that is rarely explored by Kenyan companies outside the financial sector, some are warming up to it. In May this year, Crown Paints announced a rights issue intended to give the paint manufacturer financial flexibility to mitigate the challenges posed by the ongoing Covid-19 pandemic and boost the company's growth strategy as it seeks regional expansion. TransCentury Plc which operates subsidiaries in 14 countries across East, Central and Southern Africa has also sought approval from its shareholders for a rights issue to fund its turnaround strategy and raise capital for infrastructure investments across the continent.

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