

# Journal of Finance and Accounting

ISSN Online: 2616-4965



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# Effect of Equity Financing on Shareholder Value Creation of Non-Financial Firms Quoted at the Nairobi Securities Exchange

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*How to cite this article:* Muthoni, K. G., Jagongo, A. & Muniu, J. (2019). Effect of Equity Financing on Shareholder Value Creation of Non-Financial Firms Quoted at the Nairobi Securities Exchange, *Journal of Finance & Accounting*, 3(5), 32-52.

## Abstract

Equity financing involves acquisition of funds by issuing shares of common or preferred stock. Firms usually use equity financing when they are unable to raise satisfactory funds through retained earnings or when they have to raise additional equity capital to offset debt. Shareholder value creation and profit maximizing are among the primary objectives of a firm. Equity financing play an imperative role in general performance of a company and shareholder value creation. There have been a number of firms facing financial crisis among them; Mumias Sugar Ltd, Uchumi Supermarkets Ltd and Kenya Airways Ltd. All these companies are quoted at the Nairobi Securities Exchange. Due to declining performance of these companies, share prices have been dropping and shareholders do not receive dividends. This study investigated the effect of equity financing on shareholder value creation of non-financial firms quoted at the Nairobi Securities Exchange for the period 2008-2014. The study was guided by; Pecking Order Theory and Market Timing Theory. This study used general and empirical models from previous studies as a basis for studying specific models which were modified to suit the current study. The study was guided by the positivism philosophy and employed explanatory design which is non-experimental. Census design was used as the number of non- financial firms at the time of the study was 40 companies. The data was gathered from NSE handbooks and CMA publications comprising of annual financial statements, income statements and accompanying notes. Ordinary Least Square regression analysis was conducted to examine the effect of equity financing

decision on shareholder value creation. The results revealed that equity financing had a statistically significant positive effect on EVA. The study further analyzed sector based differences among companies listed at the NSE. The results indicated significant differences among various sectors in respect to the effects of equity financing on shareholder value creation. Feasible generalized least squares were used to estimate the model. Diagnostic tests were conducted to ensure non-violation of the assumptions of Classical Linear Regression Model. Among the tests conducted; includes panel unit root test, Autocorrelation, Homoskedasticity tests. Study model tests showed that, there was non-violation the assumptions and hence the model found fit for further analysis. The study recommends that managers of quoted non-financial companies should strive and practice periodic shareholder value creation analysis for continuous assessment of growth process. The government through the CMA should come up with regulatory framework that guide firm listed in enacted dividend policies. Further it is recommended that shareholder value creation report is enforced as an additional statement published by the firms quoted at the NSE, Kenya.

**Key Words:** *Equity, Financing, Shareholder, Value Creation, Non-financial, Firms*

### **1.1 Background of the study**

Investors, management and other stakeholders need to be aware of the company's performance to enable them make informed decisions about the future. Rational investors expect good long term return on their investment. Chauhan and Patel (2013) observed that maximizing shareholders' value is becoming the new co-operate standard. Managers strive to achieve this objective by making rational financing decisions regarding combination of finances which would minimize its cost of funds. Hartomo (2014) opines that, creation of shareholder value is becoming increasingly challenging as owners and managers are forced to make appropriate financial decisions that contribute to the management of operations that create value and also identify activities that destroy value. In addition it is necessary to implement effective instruments which are able to evaluate real value created.

The choice among financing options aims at finding the right financial structure that will maximize stockholders wealth. Oladele (2013) opines that organizations seek efficiency in performance and create value in terms of improved wealth for their shareholders and increase satisfaction to their customers and other stakeholders. Company value is estimated by means of future cash flows and new value is created only when the income obtained from capital invested cover the attracted capital expenses (Alaxei, 2015). Chauhan and Patel (2013) note that, shareholders' wealth is measured in terms of returns received on investments which could either be in form of dividends, capital appreciation or both. Capital appreciation depends on the changes in the market value of stocks. Market value of stock depends upon a number of factors ranging from company specific to market specific (Sharma, 2010). Changes in shareholders wealth are inferred mostly from changes in stock prices, dividend paid and equity raised during the period. Andrei and Oleg (2013) observe that stock prices reflect investors' expectations about future cash flows which reflect the intrinsic value of the firm. Creating wealth for shareholders

requires firms to undertake investment decisions that have a positive net present value (NPV). Projects are expected to earn return above the cost of fund and cumulative appreciation in value.

According to Oladele (2013), shareholder value creation occurs when a company generates more wealth for shareholders than they are able to generate for themselves. Jalaja (2010) observes that value creation involves much more than merely monitoring firms' performance; rather management team should be actively involved in the process of value creation. Vijayalakshmi and Manoharan (2013) note that, equity shareholders as the owners of the company expect high and stable return on capital supplied by them and are more concerned with utilization of funds by the company. Lukayu and Mukanzi (2015) posit that shareholders' perspective could have a bearing on how well the management of a company articulates the creation of shareholder value. Moreover, maximizing shareholders' value requires knowledge about sources of value creation and destruction within the firm as well as the value implication of any new strategy and policies contemplated (Hall, 2013).

Jalaja (2010) observed that, in a contemporary globalized economic landscape, competition for shareholders funds are becoming increasingly intense thus companies must strive to offer adequate rate of return to investors in order to remain relevant and ensure continuous funding. Capital markets are becoming increasingly global and investors can rapidly shift their investment in higher yielding opportunities. In addition, investors are becoming socially responsible by limiting their investment funds to companies that care about all stakeholders. According to Hall (2013) a move towards shareholder value has been driven by continued globalization of capital markets, increased focus on co-operate governance, rising shareholders activism and investors move towards cash flow based evaluation. Furthermore, the company that is destroying value always fights to attract further funding to finance growth. Most competitive management teams are responding to increased pressure to create value by embracing new metrics and new models for managing companies. Kumar and Tawari (2015) note that, investment funds are scarce and are more mobile, thus, to attract the funds, firms should submit themselves to the scrutiny of all stakeholders. Jalaja (2010) observed that rewarding shareholders is one of the best ways of ensuring that other stakeholders are served as well.

According to Hall (2013) the 2008 economic turmoil experienced in the world market changed the financial climate and perception of value. Shareholder value creation and reporting is slowly becoming the global yardstick for measuring organization performance (Jalala, 2010). It has become apparent for companies to recognize and rectify ways of determining value, value drivers and improve returns from investments. Some of the financial changes noted include investment returns, which are more uncertain, volatile and relatively lower than they were a decade ago. Jalaja (2010) observes that, value creation involves much more than solely monitoring firm performance value; rather, value is created when managers actively participate in firm's process of identifying good investment opportunities and taking steps to capture their potential value, which promotes growth and sustained improvement.

Every company strives to achieve success, yet success can be defined in many different ways. The concept of shareholder value creation is based on several factors such as capital

appreciation, market value, regular income return on investment, leverage, dividend payout ratio profit consistency among other variables. As a result, management teams of companies should make decisions based on a set of goals and values that aims at optimizing value for different stakeholder in the company. Oladele (2013) notes that, shareholders wealth maximization is considered as one of the most appropriate goal as it encompasses incentive for efficiency, long-term growth, development and value creation. Shareholders wealth is represented in market price of company's ordinary stock. According to Marouan and Moez (2015) shareholder wealth is a function of a company's investment, financing and dividend decisions. Floarea (2008) asserts that suitable financing options allow corporations to increase their net income thus appeasing shareholders. Residual income above shareholders expectations represents value created. This excess is assumed to be reflected within the share price of a company, thus in estimating value creation it is important to consider market perception towards the company.

Equity financing involves acquisition of funds by issuing shares of common or preferred stock. Firms usually use equity financing when they are unable to raise satisfactory funds through retained earnings or when they have to raise additional equity capital to offset debt. However, the most critical assumption that accountants make is that equity finance is a free resource (Lukayu & Mukanzi 2015). Abor (2008) observes that listed companies are in a better position to raise equity finance from securities market whilst large scale unquoted firms source equity finance from institutional investors usually through private placement.

Shareholder value analysis should be applied since it provides a framework for linking management decisions and strategies of creating value. Panigrahi, Zainuddin and Azizan (2014) argue that management is required to pay attention to decisions that can create value for shareholders while making investments and financing strategies as they have an impact on value generated for the shareholder. There is satisfactory literature that supports shareholder value approach; however there is ambiguity as to how shareholder value should be measured (Shayan, 2013). Companies may employ accounting measures or value based measures. Accounting measures are viewed to be short term, subjective and prone to manipulation. Value based measures are objective, and focuses on long term multilateral perspective on company's performance. There are a number of shareholder value creation indicators including Economic Value Added (EVA) and Market Value Added (MVA). Proponents of value based measures argue that they offer a basis for comparison between companies and incorporate cost of capital which accounts for the degree of risk of a company. Sirbu (2012) supported the same and observed that Value based management models are more correlated with economic profit unlike the accounting based ratios

Companies are created to benefit their owners by providing them with maximum return. Hall (2010) observes that, increasing shareholder value requires knowledge about the sources of value creation and destruction within a company and industry. Value drivers can be classified as either financial variables or non-financial variables. Firms have different unique characteristic and the management of a firm should identify special variables that have higher influence on the market value. Continuous application of such variables in a firm will eventually increase shareholder value (Tiwari& Kumar 2015). Chauhan (2012) notes that firms analyze value creation for

different reasons, key among them; formulating and examining strategy, influence peoples' behaviors and to externally validate firm performance. According to Kumar (2015), identification of financial factors with highest impact on value creation in a firm may facilitate establishment of an acceptable standard for appropriate strategy. However, strategies adopted have varying effects on shareholder value creation which depends on the metrics employed in a model (Atiyet 2012; Kapoor 2009).

In Indonesian, companies with operational excellence and strong competitiveness succeeded in value creation in the long term (Hartomo, 2014). In addition, a company's ability to properly manage its financial structure produced low cost of capital which supported the process of the value creation. In Russia, Ankudinov and Oleg (2014) assert that, investment in long-term financial assets is negatively related to both company market value and return for its shareholders. Atiyet (2012) observed that, French firms' shareholder value creation is dependent on the measure taken. Oladele (2013) notes that, in Nigeria, Shareholder value creation is highly dependent on operating expenses, profit margins return on capital employed and expenses ratio. Hall (2010) observes that efficient financing, appropriate fixed asset and working capital management becomes top priorities in South African companies. Empirical literature shows that shareholders' value orientation builds more attractive companies not only for investors, but for employees, customers and also other stakeholders. The studies observed different variables affecting the shareholder value creation on financial and non- financial companies.

The Nairobi Securities Exchange voluntary association of stockbrokers in the European community was constituted in 1954 as registered under the societies Act. The idea of the Nairobi Stock Exchange was facilitated by the birth of the Company Act 1948 (Cap 486). The Nairobi Securities Exchanges is a full service securities exchange which supports trading, clearing and settlement of equities, debts derivatives and other investment tools. Generally, securities market and financial sectors play an important role in the growth and development of any economy. Empirical studies confirmed that a well-functioning capital market increases economic efficiency, investment and growth. The NSE has classified listed companies into ten sectors which include; the agricultural sector, automobiles and accessories, banking sector, commercial and services sector, investment sector, manufacturing and allied sector and telecommunication and technology sector. These sectors are further grouped into two main categories; financial firms and non- financial firms. Financial firms are highly regulated by the central bank on issues of liquidity, asset and capital holding and provisions among other factor. The current study excluded financial firms due to their unique nature in as far as financing decisions are concerned.

Oyuga (2014) notes that some investors especially long term investors are interested in capital gains and are keen on movement of share prices. An increase in share prices for an investor would mean a growth in the value of their investment and a share price decrease would be viewed as a decrease in the value of their investment. An analysis of the NSE performance for the period between 2008 and 2010 revealed that the macro-economic environment has been very volatile slowing down a sustained stable financial market for long term resource mobilization (Aroni, 2011).Reddy (2012) opines that stock prices of quoted companies are affected either positively or negatively by a number of factors occurring within or without the economic system.

Factors affecting market returns could be micro-economic such as profits, business growth and dividend announcements among other factors or macro-economic factors such as inflation, GDP and interest rates which also affect the overall return in the market (Omondi & Muturi, 2012).

The operating loss reported by Kenya Airways Company Ltd went up by 69.8% from 2012/13 to 2013/14 financial year. The capital reserve went down by 9.8% in the same period while loss per share went up by 68.6% from 2013/14 to 2014/15 financial year (CMA, 2015). In Mumias Sugar Company Ltd dividend per share was 0.40 in 2010 and 0.00 in 2014. Earnings per share dropped from Ksh 1.03 in 2010 to (1.77) in 2014 (NSE, 2015). A number of companies that were delisted or suspended from 2005 to 2015 caused financial losses to their shareholders since they could not transact or liquidate their shareholdings (Capital Market Authority, 2015). Majority of financially distressed companies are non-financial firms; this motivated the contextual choice of the study.

## **1.2 Statement of the Problem**

Companies are formed to benefit their owners by providing them with maximum returns and capital appreciation and the primary objective of a firm is to maximize the shareholders' value. A Company's shareholder value creation is a function of financing decisions and investment decisions made by the management. However, in a value driven economy some companies create value while others destroy shareholder value (Narang & Mandeep 2014). Whenever value is destroyed there is always a high possible threat of hostile takeover, drop of stock price, failure to meet financial obligations which could lead to receivership and consequent liquidation. Such threats have a negative impact on shareholders stake in a company, loss of employment, inadequate supply of consumer products, failure to contribute to economic activities among others.

Kenya has experienced a number of companies facing financial crises from 2008 to 2014; some of which are listed at the NSE. Kenya Airways Ltd reported huge losses in their 2013/14 financial year ending March 2015, to a tune of 25.7 billion. Mumias Sugar Company Ltd has been struggling financially; in June 2015 the government bailed it out to a tune of one billion shillings to try and stem a 6 billion shillings cash crunch. During this period, investors lost in terms of value of their investments to a tune of close to ksh 84 billion (NSE 2014). As a result a number of investing public lost confidence with the stock market and they would rather invest where they perceive growth and value addition. The average individual holdings at the NSE dropped from 26.9% in 2007 to 13.0% in 2014 (CMA, 2015).

Mwenje and Olweny (2016) investigated the impact of private equity on value creation among listed firms in Kenya. This study found that financial modification had no or little impact on shareholder value creation while strategic and operational indicator demonstrated significant impact. Lukayu and Mukanzi (2015) conducted a study to assess firm attributes on shareholder value in listed Banks in Kenya. The study found that risk and profitability had a strong influence on shareholder value creation. Mafouan and Moez (2015) investigated the impact of corporate governance on shareholder value creation in Tunisia. Study results showed that, capital concentration have a negative effect on performance and value creation. Atiyet (2012) analyzed

the impact of financing decisions on shareholder value creation in France; self-financing was found to positively influence shareholder value, while debt and equity negatively influenced shareholder value. Available studies analyzed financing variables separately, thus making it extremely difficult for cumulative effect on shareholder value creation to be ascertained. Limited research studies are available on the effect of equity financing on shareholder value creation in developing economies. This study therefore sought to fill this gap by determining the effect equity finance has on shareholder value creation using EVA, which is an economic value based metric as an indicator of shareholder value creation.

### **1.3 Objective of the Study**

To determine the effect of equity financing on shareholder value creation of non-financial firms quoted at the Nairobi Securities Exchange.

### **1.4 Research Hypothesis**

H<sub>0</sub>: Equity financing does not have a significant effect on shareholder value creation of non-financial firms quoted at the Nairobi Securities Exchange.

## **2.0 Literature Review**

### **2.1 Theoretical Literature Review**

#### **2.1.1 Pecking Order Theory**

The theory was authored by Myers and Majluf (1984). The theory was then extended by Lukas and Mac Donald (1990). According to this theory firms prefer internal funding over external funding. In case the firm requires external funding they would prefer debt over equity and equity is generated as a last resort. So the firms do not have predetermined or optimum debt to equity ratio due to information asymmetry. Firms adopt a conservative approach when it comes to dividends and use debt financing to maximize the value of the firm. One of the aspects of the pecking order theory implies that when it comes to profitable firms, they would always prefer internal financing rather than taking up new debts or equity.

Myers (1984) observes that firm managers have better information about the firm and its projects than less informed investors. Moreover, managers know more about the intrinsic value and riskiness of the firm than the shareholders and other stakeholders. This argument was supported by Fama and French (2000) who found out that a profitable firm tends to be less levered as compared to a non-profitable firm. The theory stands on presumptions that debt issuance sends a market signal that the firm is confident in its ability to service debt regularly while equity issuance sends a market signal that the firm may be overvalued, potentially leading to a share price drop. Frank and Goyal (2003) observe that the greatest supporters of the pecking order theory are large firms that are expected to face the least adverse selection problems because they receive better coverage by equity analysts. Based on these assumptions this study sought to investigate whether non-financial firms' choice of financing affects the shareholder value creation.



### **2.1.2 Market Timing Theory**

The theory was proposed by Barker and Wurgler (2002). The theory states that the current capital structure is the cumulative outcome of past attempts to time the equity market. Market timing implies that firms issue new shares when they perceive that the shares are overvalued and that firms repurchase own shares when they consider them undervalued. Barker and Wurgler (2002) observe that there is evidence that equity market timing has a persistence effect on the capital structure of the firm. Barker and Wurgler (2002) note that, certain factors influence security decisions such as; past stock prices, interest rate conditions and time-varying adverse selection cost of equity issuance.

The theory argues that, managers are able to identify a certain window of opportunity during which equity issuance is less costly due to mispricing. Furthermore, managers time the securities they issue. Given this argument, when the market values of equities are high, relative to book value and past market valuations, managers will tend to prefer equity financing over debt financing and vice versa. This also indirectly implies that managers would purchase equity when their valuations are low. Effectively managers are able to increasing the value of the firm by lowering the overall cost of capital. This study sought to establish the timing effects of equity financing decisions on the overall cost of finance on non-financial firms quoted at NSE.

### **2.2 Empirical Literature Review**

Mwenje and Olweny (2016) studied the impact of private equity on value creation among firms listed at the NSE Kenya. A causal research design was adopted and the return on equity and return on assets were used as value creation proxies. The independent variables generated from three central pillars of private equity model comprising of financial, operational and strategic segments were analyzed. The findings of the study showed that financial modifications in capital structure had little or no impact on value creation metrics. On the other hand both operational and strategic indicators demonstrated predominantly significant causal association with value creation. The study sought to evaluate value creation using accounting metrics. The present study employed value based ratio to analyze the effect of shareholder value creation.

Zhu and Wang (2013) sought to analyze equity financing constraints and corporate capital structure in China. The purpose of the study was to investigate how uncertainty of equity financing brought about by equity financing regulations in emerging capital markets affects the company's capital structure decisions. The study developed a theoretical model that tried to introduce equity financing uncertainties into the company's capital structure decision making. The findings showed that the firm value would decrease with the uncertainty of equity financing because of the relationship between firm's future cash- flows and the financing policies. The numerical solution of the model suggested that the uncertainty of equity financing is an important factor affecting the choice of optimal capital structure. The present study sought to analyze the effect of equity financing on the shareholder value creation.

Bougatef and Chichi (2010) investigated the relevance of market timing considerations on debt and equity choice using panel of Tunisian and French firms. The study showed that firms tend to issue equity when their market valuations are relatively higher than their book values and after

market performance improves. This is in consistent with market timing theory. As a consequence these firms become under-leveraged in the short-term and this impact of equity market timing on capital structure persists beyond eight years. Elliot *et al.* (2009) observes that the equity market timing theory of capital structure proposes that managers should be able to identify times when equity is less costly compared to other types of external financing due to the markets overvaluation of the firm’s stock.

### 2.3 Conceptual Framework



**Figure 1: Conceptual Framework**

### 3.0 Research Methodology

The study was founded on the positivism paradigm. Gephart (1999) classified research paradigm into three philosophically distinct categories as positivism, interpretivism and critical postmodernism. Positivism is grounded on the theoretical belief that there is an objective reality that can be known to the researcher if correct methods are applied in the correct manner (Saunders, Lewis & Thornhill, 2009). The current study followed the positivism stance within epistemology which involves perception of knowledge. Furthermore the result was generalized and the researcher had no direct influence on the variables. This study adopted the explanatory, which is non-experimental. Kerlinger and Lee (2000) observe that is used this research design is used when variables of interest cannot be manipulated. The study focused on all non-financial quoted in the Nairobi Securities Exchange (NSE). The NSE had 41 non-financial companies as at 31<sup>st</sup> December 2015. The unit of analysis was motivated by the fact that quoted companies invite the public to invest their hard earned income. The target companies were screened against various factors which included availability of data and integrity of data, thus the study only considered unqualified audited reports. The total number of non- financial companies listed at the NSE, as at 31st December 2015 was 41. This study therefore considered census approach as more appropriate. The study used panel data which was estimated using various models among them; pooled effect, random effects and fixed effect. The key consideration in company fixed effects and random effects estimator was based on whether the unit effects are correlated with any of the explanatory variables and therefore random effect biased (Hausman, 1978; Wooldridge, 2012; Baum, 2005).

To analyze the effect of equity financing on shareholder value creation of listed companies at the NSE. The study adopted and modified the basic static model as proposed in Radic (2015)  $Y_{it} = \alpha_i$

$+X_{it}\beta+C_t+\varepsilon_{it}; i=1... N, t=1... T$ , the independent variables are expressed in a multiple regression equation, where shareholder value creation is measured using EVA expressed as:-

$$EVA_t = NOPAT_t - (WACC * IC_{t-1})$$

Where,  $NOPAT_t =$  Net Operating Profit after Tax at time t

WACC= Weighted Average Cost of Capital.

$$WACC = \frac{Debt}{Debt+Equity} Rd \times (1 - tax\ rate) + \frac{Equity}{Debt+Equity} Re$$

Where:  $Rd =$  interest rate

$Re =$  investors cost (investors expected return).

$IC_{t-1} =$  Invested Capital at time (t-1)

The cost of equity finance was estimated using CAPM formula. The model was adopted and modified as proposed in (Stewart, 1990; Mamun & Mansor, 2012). It was expressed as follows;

$$Re = Rf + \beta_i ((R_m) - Rf)$$

$$\beta = \frac{\Delta Ri}{\Delta Rm}$$

Where;  $Re =$ Cost of equity

$\beta_i =$  Market beta; representing a coefficient of the change of the company's share price compared to overall market index.

$R_m =$  Return in the Market

$R_f =$  Risk free (Treasury bond rate of return).

The data includes both time series and cross section dimensions; hence, a linear panel regression was estimated as proposed in Baltagi (2005).

The study's general empirical model was defined as follows.

$$Y_{it} = \alpha_t + X_{it}\beta_k + \varepsilon_{it} \dots \dots \dots (3.1a)$$

The Equation was transformed to Random Effects Model by specifying  $\varepsilon_{it}$  and was expressed as shown in Equation 3.1b.

$$\varepsilon_{it} = V_i + U_{it} \dots \dots \dots (3.1b)$$

Where  $Y_{it}$  is the dependent variable denoting shareholder value creation of company  $i$  at time  $t.i$  denotes the target companies,  $I = 1... 40$  while  $t$  represents the observed time period  $t = 2008, 2014$ ;  $X_{it}$  is  $1 \times K$  vector of explanatory variables  $\beta$  are coefficients to be estimated,  $\alpha$  is a

constant term and  $\epsilon_{it}$  is a composite error term.  $V_i$  denotes heterogeneity effects and  $U_{it}$  denotes idiosyncratic disturbances as cited Baltagi (2005).

The equation 3.1 was expanded to obtain equation 3.2 which was used for estimation.

$$\text{Log EVA}_{it} = \alpha + \beta \text{Log EQ}_{it} \dots\dots\dots (3.2)$$

Where;

$\text{EQ}_{it}$  = equity finance of company  $i$  at time  $t$

$\epsilon_{it}$  = composite error term.

$\beta$  = coefficients of explanatory variable.

$\alpha$ , = constant term

#### 4.0 Research Findings, Interpretation and Discussions

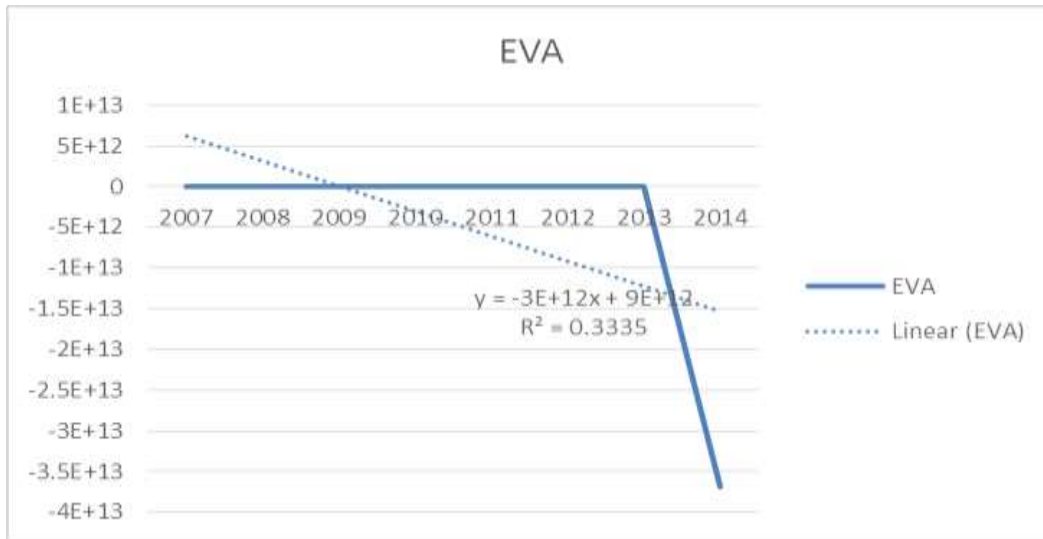
##### 4.1 Descriptive Statistics

**Table 1: Descriptive Statistics**

Variable	Minimum	Maximum	Mean	Std. Deviation
EVA(billions)	-939895.550	0.61504807	-478.814	59992.529
Equity Financing (millions)	1232910	474687545	16393280	55739246

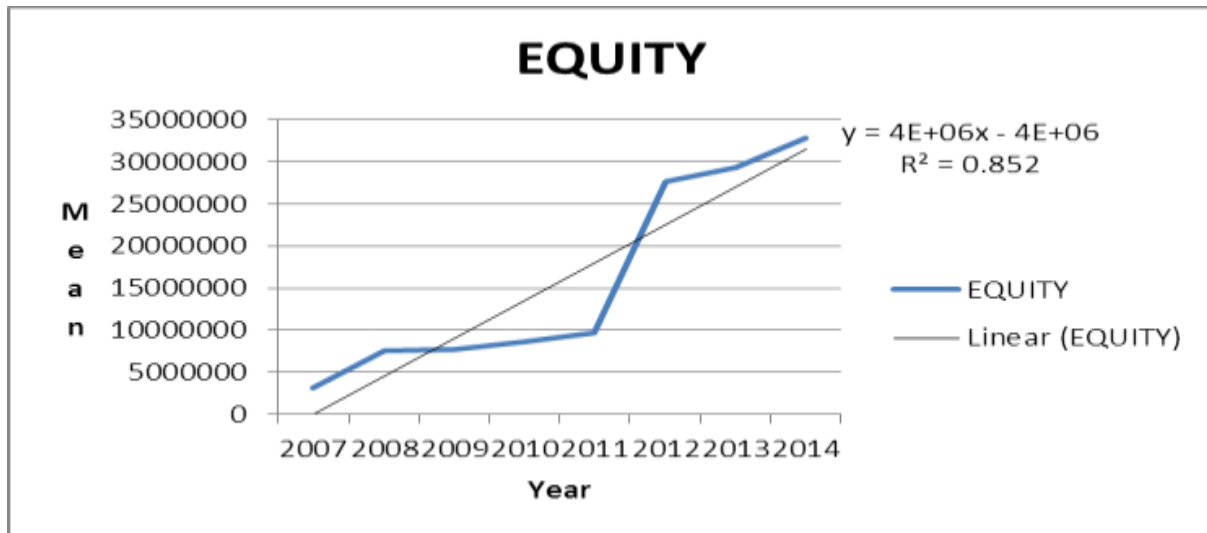
As indicated in the table 1, the total mean of EVA for the period 2008 to 2014 was Ksh-478.814 million with a standard deviation of Ksh59992.529 million indicating a large variability in EVA over time. This implies that some companies created huge value while others reduced shareholders value. The negative EVA value shows that, on average the companies listed at the NSE did not realize return exceeding cost of equity, thus decreased shareholders' value within the period of study. The Minimum and maximum, values of EVA over the same period of time were Ksh -939895.55million and Ksh0.61504807 million respectively. Positive return indicates that some companies created shareholders value. Negative EVA shows there were companies that destroyed shareholder value within the period of study as observed in Narang and Mandeep (2014). The huge negative as compared with small positive indicates that investors' hard earned investments reduced in terms value. This is an indication that the capital invested did not fetch enough return to cover cost of that capital, thus shareholder wealth destruction. Unfortunately most of these companies reported good profits as recorded in the income statement over the period under review. This observation implies that there is a difference between reporting profits and value creation. However, reporting profits consistently plays a vital role in eventual value creation as profits drives value. According to Venugopal and Reddy (2016), profit maximization is viewed as part of shareholder value creation. A profitable company pulls shareholders to contribute funds and motive them for regular reinvestment.

The results on equity financing show an average of Ksh16393280 Million and a standard deviation of Ksh 55739246 million for the period 2007 to 2014. At the same period the maximum equity financing was Ksh 474687545 billion and a minimum, value of Ksh 1232910 Million. The results indicate a wide variation in equity financing among the firms reviewed over the study period. The huge difference is attributed to new equity issues, IPOs, and additional companies listing within the review period. Moreover, on average, non-financial companies quoted at the NSE used equity financing for their operations.



**Figure 2: Trend of EVA for the year 2008-2014**

Figure 2 shows the EVA trend for the 40 companies from the year 2008 to 2014. The trend line indicates that EVA has been consistent from the year 2008 to 2012. The values remain zero or almost zero indicating in general the firms quoted at the NSE did not create any value for their shareholders. It then dropped sharply in the year 2013. The results indicate a decrease in value creation among the firms under observation. From 2013 to 2014 the results show that most companies destroyed shareholders' value. Gaunder and Venkateshwarlu (2017) observed that the higher the EVA the higher the shareholder value created. According to Stewart (1991) positive EVA companies provide higher returns than they can earn investing the same funds elsewhere. The investors could sell their investments for a premium- book- value. When EVA is zero it implies that the firm just met investors' expectation, the shares sell at book value. The negative EVA indicates that firms destroy investors value thus should sell at a discount to book value.



**Figure 3: Trend of Equity for the year 2008-2014**

Figure 3 shows equity trend for 40 companies analyzed from the year 2008 to 2014. Trend indicates that equity has been on a moderate increase from the year 2008 to 2014. This shows an increase in equity financing among the firms under consideration.

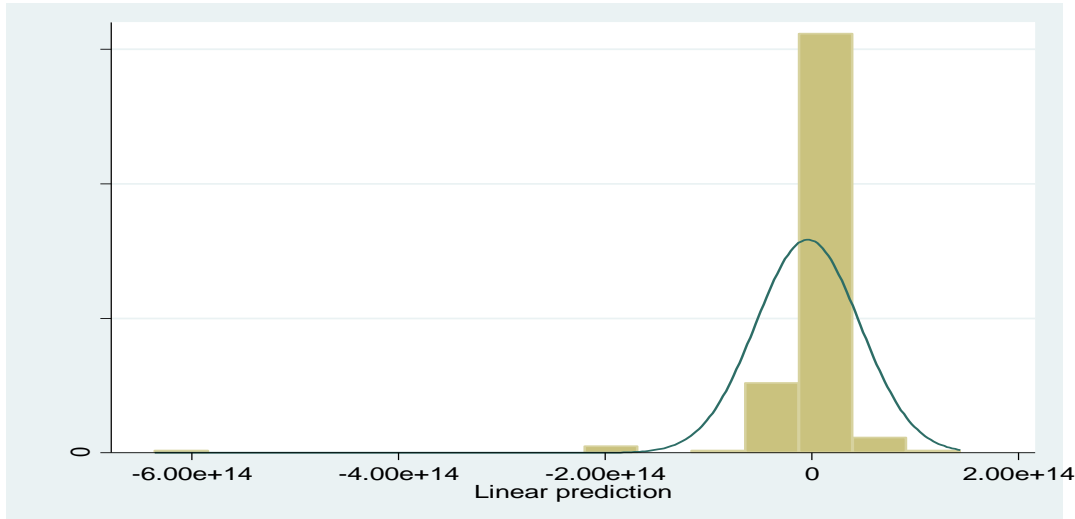
**4.2 Diagnostic Tests Results**

**Table 2: Unit root results**

Variable	Level	Test	Unit Root Tests			
			ADF test		PP Test	
			Statistics	P-value	Statistics	P-value
EVA	Level	Inverse chi square	37.034	0.000	82.476	0.000
		Inverse normal	24.704	0.000	59.453	0.000
		Inverse logit	38.79	0.000	86.068	0.000
		Modified Inverse chi square	42.006	0.000	68.187	0.000
Equity	Level	Inverse chi square	11.162	1.000	103.507	1.000
		Inverse normal	61.271	1.000	29.428	1.000
		Inverse logit	-5.871	1.000	38.843	1.000
		Modified Inverse chi square	69.531	1.000	98.774	1.000

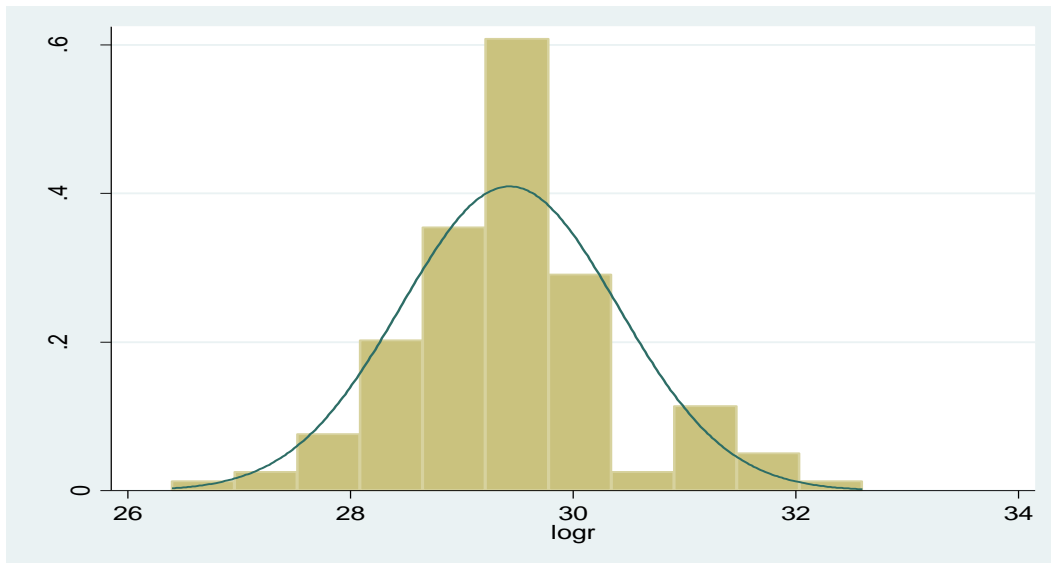
Results in Table 2 indicated that all the variables are stationary (i.e. absence of unit roots) at 5% level of significance with the exception of Equity which became stationary on its 1<sup>st</sup> difference.

The researcher used log (equity financing) for subsequence testing, otherwise the basic equity financing would give spurious results as noted in Chen (2013).



**Figure 4: Histogram before using log of residuals**

The residuals were transformed into their natural logs. The results from the graphical method are presented in Figure 4. They indicate that the natural logs of the residuals are normally distributed.



**Figure 5: Histograms of residuals**

**Table 3: Jarque-Bera test/Skewness test for Normality**

Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	adj chi2(2)	Prob>chi2
Log residual	140	0.1815	0.0192	6.8	0.0334

The null hypothesis under this test is that the disturbances are not normally distributed. If the p-value is less than 0.05, the null hypothesis of normality at the 5% level will be rejected. Given that the p-value = 0.0334 is less than 5% for the residual, the null hypothesis was rejected and thus the conclusion is that the residuals are normally distributed.

**Table 4: Heteroskedasticity Test Results**

**Modified Wald test for group wise Heteroskedasticity in fixed effect regression model**

H0:  $\sigma(i)^2 = \sigma^2$  for all i

chi2 (35) = 1.0e+34

Prob>chi2 = 0.0000

The null hypothesis in the test is that error terms have a constant variance (i.e. should be homoscedastic). The likelihood-ratio result shows a chi-square value of 340 and a p-value of 0.0000. The chi-square value was significant at 5%. The null hypothesis of constant variance was rejected, signifying existence of Heteroskedasticity in the study data. To address this problem the study employed FGLS estimation model as suggested in Poi and Wiggins (2001) and Wooldridge (2012).

**Table 5: Serial correlation Results**

**Wooldridge test for autocorrelation in panel data**

H0: no first-order autocorrelation

F( 1, 34) = 0.564

Prob> F = 0.4577

The results as indicated in Table 5 show p-value=0.4577 and the F test. This implies that at 5% level of significance the F test was not significant hence; the study fails to reject the null hypothesis of no autocorrelation and thus conclude that residuals are not auto correlated.



**Table 6: Hausman Results for EVA**

Variable	(b) fixed	(B) random	(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
Equity Financing	-2967168	-1629859	-1337310	624261.3

b = consistent under Ho and Ha; obtained from xtreg  
 B = inconsistent under Ha, efficient under Ho; obtained from xtreg  
 Test: Ho: difference in coefficients not systematic  
 $\chi^2(1) = (b-B)'[(V_b-V_B)^{-1}](b-B)=0.10$   
 Prob>chi2 = 0.7483

In order to choose between fixed and random effects model, the Hausman test was presented in Table 6. The null hypothesis of the Hausman test was that the random effects model was preferred to the fixed effects model. Hausman test result indicates a chi-square of 0.10 with a p-value of 0.7483 implying that at 5 percent level, the chi-square was statistically insignificant. The study therefore failed to reject the null hypothesis that the random effects model was preferred to the fixed effects model as proposed in (Green 2012).

### 4.3 Correlation Analysis

**Table 7: Correlation Matrix Results**

Variable	EVA	Equity Financing
EVA	1.000	
Equity Financing	-0.2889*	1.000

\* Rep 5 percent level of significant.

The results are as presented in the correlation matrix in Table 7. Only those variables which were statistically significant were reported. Results revealed that Equity Financing is negatively and significant associated with EVA. The results corroborate Atiyet (2012) findings that Equity issue was negative and significantly associate with EVA. In addition the results agree with Myers and Majluf (1984) that equity issue affects the share value of existing shareholders and consequently destroy their value as it dilutes ownership.

**Table 8: Regression results on Equity Financing and EVA**

<b>LOGEVA</b>	<b>Coefficient.</b>	<b>Std. Error.</b>	<b>z</b>	<b>P&gt; z </b>
Log D(Equity Financing)	0.7814692	0.1106063	7.07	<b>0.000</b>
Constant	3.817358	1.460191	2.61	0.009
R-Squared =0.4146				0.000
F statistic =7.854, p=0.000				

The optimal model is;

$$\text{Log EVA} = 3.817 + 0.7815X$$

Where,

$$X = \text{Log D (Equity financing)}$$

The regression results in Table 8 show that equity financing is positively and significantly related with EVA ( $r=0.7815$ ,  $p=0.000$ ). This implies that a unitary increase in equity financing results in an increase in EVA by 78.15% per unit. Equity financing explains 41.46% of the variations in the dependent variable (EVA). The results corroborate Abor (2008) study that, listed companies are in a better position to raise equity finance from stock market and large scale unquoted firms are also able to access equity finance from institutional investors usually through private placement. The study further concurs with Zhu and Wang (2013) study which revealed that uncertainties in equity financing decrease firm value. However, the study results contradict Mwenje and Olweny (2016) study that financial modifications have little or no value creation. The null hypothesis was that there is no statistically significant effect between equity financing and EVA in non-financial firms quoted at the NSE, Kenya. Since equity financing had a p value= (0.000) which is less than 0.05 as shown in Table 8, the hypothesis was rejected. Therefore there is a statistically significant effect between equity financing and EVA of non-financial firms quoted at the NSE, Kenya.

## 5.0 Conclusion

The study established that equity financing affect shareholder value creation differently. Equity capital financing recorded the highest influence on stand-alone analysis; the study established that equity has a positive and statistically significant influence on shareholder value creation. The study therefore concluded that equity financing has a positive effect on shareholder value creation.

## 6.0 Recommendations of the Study

The results of this study draw significant policy implications at micro and macroeconomic levels. Decisions related to choice of appropriate sources of fund are crucial since they have impact on continuous value creation and maintenance. To enhance and maintain value creation, management should aim at minimizing weighted average cost of capital, analyses inherent risks associated with various capital and investment projects and aim at maintaining firm's credibility.

This will ensure continuous supply of both short term and long term finances and boost investors' confidence in a firms going concern.

The study recommends that, companies listed at the NSE, should start disclosing EVA statement as part of financial information in their annual reports. The management should endeavor to improve the quality of annual reports in terms of content and disclosures. The financial manager should analyze the cost of various sources of finance as this has a direct effect on WACC as well as value created. Various sectors should keenly evaluate the type of financing decision that creates most value as well as those that destroy value, and act accordingly. EVA could also be used as a benchmark performance indicator for evaluation and correction purposes. The firm managers should strive and practice periodic shareholder value creation analysis for continuous assessment of growth and development process. In addition EVA values would act as a comparison tool within a company as well as in industries. Moreover, EVA could be used to guide investors and other stakeholders in investment decision making processes. The NOPAT was found to be a key component in determining and measuring shareholder value creation. Thus managers should diverse strategies and policies to continuously improve and maintain its value

Based on the findings, this study recommends to the Capital Market Authority (CMA) which is mandated by the Kenya government to come up with regulatory framework that guides firms listed at the NSE should be more vigilant in ensuring that regulations are enacted to enhance the quality of firms' disclosure of all relevant information. In addition to regular financial statements and reports, CMA should enforce reports on value creation for all companies quoted at the NSE, Kenya. Statement on shareholder value creation could improve the quality of financial information for better investment decisions, financing decisions and other managerial decisions. Moreover, analyzed information and reports would be more representative for better decision making and ensure investors and other stakeholders are protected. CMA should encourage investors lobby groups involved in creating awareness and seeking information on firms that create shareholder's value as well as the firms that destroy shareholder's value.

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