AN EMPIRICAL ANALYSIS OF WHY FIRMS GO PUBLIC: THE NIGERIAN EXPERIENCE

BY

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DECLARATION

I hereby declare that this thesis is original and is based on my own research work. It has not been submitted anywhere else for a higher degree or for publication. Quotation and their sources are duly acknowledged by means of text references. The sources of information used in the study are also shown in the references.

Declared this day.
4 / 11 /2000

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CERTIFICATION

The thesis title "An Empirical Analysis of Why Firms Go Public: The Nigerian Experience by Jegede, Rufus 'Biodun meets the regulations governing the award of the degree of Master of Science (Economics) of Ahmadu Bello University and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

This work is dedicated to the almighty God.

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My foremost gratitude goes to Almighty God for His sustaining and enabling grace throughout my study. Much energy, time and money went into the task of bringing the study to completion. He supplied it all.

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ABSTRACT

Going public benefits a firm, the investing public and the entire economy. However, many firms have not accessed the market for investment funds. They opt to remain private and the share s are tightly held. Our work is aimed at finding out the motives that underlie a decision to go public.

Our study examines extensively ex-ante and ex-post characteristics of some firms that are listed on the Nigerian stock exchange. It examines for instance, the operating performance of firms pre and post initial public offerings (IPOs). It also examines the financial structures of IPO firms pre and post initial public offering. Variables examined include gearing, financial leverage, return on assets (ROA), operating leverage, operating margin (ROS), earnings per share, dividends per share, pay- out ratios pre and post IPO. We also made a survey of fourteen firms that are yet to go public. We sought their opinion on initial public offering under-pricing, issuance cost, tax on dividend income, corporate tax, c r e d i t rating, disclosure, loss of control and their relationship with customers.

Management of most of the firms making primary offerings often state in their prospectuses a need for funds to take advantage of growth in market prospects. Some other firms cite a need to reduce debt-equity ratios in order to make investment less risky. Therefore, the study examines the level and changes in operating performance and financial structure pre and post IPO for selected quoted firms.

Our analysis shows a high and rising trend in operating performance pre IPO, an indication of increasing need for funds to take advantage of market growth prospects. Post initial public offerings performance also has a rising trend though the increase in efficiency and profitability is slightly insignificant. Firms seeking for initial public offering are highly geared and the trend is upward pre IPO. There is an observed downward trend in gearing post IPO, though this is not statistically significant. A highly geared firm faces high financial risk, low credit rating and scarcity of funds for new projects. Therefore, the need to change

the structure of corporate governance to reduce a firm's contractual obligations. The study shows that majority of the chief executives of unquoted firms are of the opinion that initial public offerings underpricing deters them from going public; that issuance costs are currently on the high side. Dividend, corporate and withhold taxes are currently not a motivation to go public. Disclosure does not pose serious threat to an average entrepreneur in Nigeria. Majority of them agreed that they need external funds and that they do not believe that they have high credit rating.

Some of our recommendations for increasing the number of listed firms include, (i) Prober macro-economic management to reduce the level of inflation and the relative attractiveness of debt market funding, (ii) Removal of barriers to capital inflow, (iii) Reduction in issuance cost, (iv) Protection of firms from the effect of disclosing sensitive information to rivals, (v) Establishment of Nigerian funds, (vi) Dividends tax holiday for newly quoted firm, (vii) Integration of corporate and personal income tax.

Growth in IPO will boost capitalisation liquidity, stock market integration and securities market development in Nigeria.

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LIST OF ABBREVIATIONS

ATO	Asset Turn Over
ADR	American Depository Receipt
GDR	Global Depository Receipt
DC	Dividend Cover
DY	Dividend Yield
EPS	Earning per Share
EY	Earning Yield
IC	Interest Cover
IPO	Initial Public Offerings
FL	Financial Leverage
M-M	Modigliani and Miller
NSE	Nigerian Stock Exchange
NSEC	Nigeria Securities and Exchange Commission
P-E	Price Earning Multiple
ROA	Return on Assets
ROS	Return on Sales
SHF	Share Holder fund
SSM	Second Tier Securuties Market
PRE	Before
POST	After

CHAPTER ONE

AN EMPIRICAL ANALYSIS OF WHY FIRMS GO PUBLIC: THE NIGERIAN EXPERIENCE

1.0 Introduction

The stock market performs a number of useful economic services. It mobilises long-term funds for firms; it allocates economic resources to alternative uses; it instils corporate discipline; it provides the entrepreneur with liquidity; it provides investors and the entrepreneurs with opportunity to diversify their portfolios; and it transmits information about quoted firms to investors and creditors.

Stock exchange services are useful economic services. How well does this economic rationale explain the motives of a firm seeking to go public? In other words, what motives underlie Initial Public Offerings (IPOs)? No doubt, firms have reasons for seeking listing. Ex-ante characteristics of firms either deter or motivate firms to go public. Moreover, ex-post characteristics of firms that go public also account for the desire or lack of incentive to go or stay public. A study of ex-ante and ex-post characteristics could serve to explain the true motives for, and deterrence to initial public offerings. Such a line of exposition will capture the costs and benefits of firms seeking IPO in the Nigerian Stock Exchange (NSE). Substantial cost of IPO will likely deter going public. Except where firms have the wherewithal to overcome the cost of IPO, Costs may be limiting factors to IPOs. In the same vein, where anticipated benefits of initial public offerings are not met, IPOs by firms may not be

enough to meet the demands of portfolio investors. It will adversely affect the economy.

Going public involves a number of interwoven variables. In Nigeria, it is observed that many firms remain unlisted despite meeting listing requirements. Firms that cannot meet listing requirements on the first-tier securities market are given the opportunity to list on the second-tier where the listing requirements are less stringent. Many firms have not altered their financing decision. What then are the incentives and deterrence to going public in Nigeria?

1.1 Statement of the Problem

Stock market provides alternatives for funding firms growth. Therefore, investment growth meant to take advantage of market growth prospects is often a main motive cited for IPOs (Mikkelson, Partch and Shah, 1995). On a priori grounds, therefore, firms are expected to invest more after IPOs. We want to know if there are significant empirical justifications for the self-reported motive for seeking IPO on the Nigerian Stock Exchange. In other words, is a desire to go public in Nigeria predicated on the need for funds? Moreover, operating performance variables of increased sales and profitability are often very high in a firm's scale of preference. Improved operating performance is often a stated goal of firms seeking IPOs. Are there empirical evidences to validate the stated motives? In addition to looking at the ex-post performance of firms seeking IPOs, we will observe the ex-post behaviour of IPO firms. IPOs may affect a firm's response to other important financial variables. For example, IPO may affect the cost of borrowing, line of credit and its supply. A fast growing firm has a need for substantial amount of capital. Thus, high leverage ratio

becomes inevitable. The need to reduce the leverage risk becomes inevitable if a firm must remain solvent in the long run. The need to become conservative in the capital structure is often a stated motive in IPO prospectuses. It is necessary to examine the truth of the stated motivation by looking at the state of gearing pre and post IPOs. It may equally be necessary to observe the attitudes of the controlling shareholders during and immediately after initial public offerings. For example what is the attitude of the entrepreneur towards divestment, portfolio re-balancing and diversification. Answers to such questions and many others will give insight into the true but hidden motives for IPOs. Going public is an important management decision that affects the entrepreneurs, the investors, the firm and the entire business environment. Entrepreneurs can cash in on IPOs to increase consumption, rebalance portfolio, diversify or escape from unprofitable risk instruments thereby diluting ownership and control. IPO may increase the financial benefits of owners at the expense of investing public. To the firm, going public may make investment funds more available with a reduced leverage ratio; it may increase their bargaining power with main creditors through increased credit lines. Investors have opportunity to diversify portfolio. Going public by and large increases risk instruments; increases market capitalisation ratio; and it may affect market liquidity and the financial asset base of the economy. The research will focus on some of these assumptions.

The problem of the research, therefore, centres on the following tripod stand:

i. The ex-ante characteristics of firms Pre and post IPOs

ii. The ex-post accounting performance of firms pre and post IPOs.

iii. The attitudes of firms that chose to remain private.

1.2 Research Questions

The following questions therefore need attention:

- Are IPOs undertaken to increase investment?
- Does operating performance of IPO firms improve after going public?
- Does issuance cost of IPO affect the decision to go public?
- Do firms increase their investment pre and post IPO?
- Does a firm's leverage affect the decision to go public?

1.3 Research Proposition

Going public invariably determines the fortune of owners of IPO firms. Reasons for going public in advanced industrial economies of U.S.A., Italy, Sweden and Britain may not necessarily fit the conditions of firms in other economies.

Therefore, there may be other reasons other than improved operating performance and investment growth for seeking initial public offerings in Nigeria. Consequently, the study is proposing that the incentive to harm other members of the firm coalition rank high in the utility function of owners/management of IPO firms. Therefore, the character of corporate governance is a crucial determinant of the decision to go public.

1.4 Objectives of the Study

The study will focus on the following areas:

i. Examine the operating performance of quoted firms' pre and post IPO

ii. Examine the ex-post behaviour of firms' pre and post initial public offerings

iv. Examine ex-ante characteristics of firms' pre and post IPOs.

v. Examine the attitude of firms that chose to remain private.

In other words, the objective is to examine the ex-ante expectations on performance and leverage against ex-post realised values on performance and leverage with the hope of making objective inferences on IPOs in Nigeria.

1.5 Significance of the study

A study of the decision to go public or stay private will consider the costs and benefits of IPOs to investors, firms and the economy. Firstly, accurate characterisation of IPO firms may open up the possibility of boosting the stock market in Nigeria through stimulating policy options which are relevant to the growth of IPOs thereby increasing market capitalisation, liquidity and possibly greater international integration of Nigerian domestic capital markets with international capital markets.

Secondly, the study is capable of replication. The generalisations are transferable to other countries with similar characteristics as that of Nigeria. Therefore, the study has the potential of stimulating research in other sub Saharan African nations. A study of the motive for going public has the effect of stimulating research in other economies in order to determine if conclusions are sustainable across countries of similar indices of development. Replicated studies have been carried out in USA, Italy, Spain and Sweden. Evidence is similar, to a large extent, across developed industrial economies.

1.6 Research Methodology

Descriptive and analytical methods are applied in our study of the motive behind initial public offerings. Ex-ante and ex-post characteristics and behaviour of firms in our study are examined in order to have an exhaustive study of the advantages and disadvantages of going public. Morcover, supportive evidences were obtained from firms, which chose to remain private even after meeting listing requirements.

Sources of data: Primary and secondary data are employed. Data on assets, liabilities and net worth as well as operating performance are extracted from the balance sheets and operating statements of selected quoted firms. Initial public offerings prospectuses and NSE Facts book are examined. The aim is to make a comparative study of important performance variables and also their characteristics before and after IPO. This was made for time t=1, 2, 3 post IPO and t=-1, -2, -3 pre IPO. Questionnaires were also administered to firms, which chose to remain private. A five point Likert scale rating was administered to the chief executives of selected firms. The information in the questionnaire is meant to study the attitude and strength of opinions of the Chief executives of unquoted firms.

Ratios, frequencies, mean attitudes, opinions and characteristics and graphical methods are employed to summarise and analyse the data. Global F ratios are employed to test the coefficients. More over post HOC Scheffe and Turkey tests are employed to determine the sources of the differences if any. Our alpha level is .05.

Variables

D_0 = Value of debts for firm i

E_i = Value of equity for firm i

Si	=	Net sales value for firm i
EBITDA	=	Earnings Before Interest, Tax and Depreciation
A_{it}	=	Net assets for period t
Ato	=	Operating leverage (asset turnover)
ROA	=	Return on Assets
ROS	=	Operating margin
Go	=	Gearing
FL	=	Financial leverage
PEM	=	Price Earning Multiple.
PO	=	Pay – out ratio
EPS	=	Earnings Per Share
DY	=	Dividend yield.
DC	=	Dividend cover
ICD	=	Issuance Cost of Debt
ICE	=	Issuance cost of equity

Our model is specified as

$$E(Y)=\beta_0 + \sum_{j=1}^{3} B_j IPO_j + \varepsilon_i$$

IPO_j = a dummy (or indicator) variable for level i

IPO_j ={ 1 if y is observed as j = 1

{ 0 if otherwise i.e. j g 1

E(y) = mean response

b_0 = mean value of y at IPO year

β_j = Mean Value of y at period j = +1, +2, +3 post IPO and j = -3 -2 -1 pre IPO

ε_i = Error term

The hypotheses below are investigated:

1. Firms go public because of the desire to reduce their debt exposure
2. Firms go public to improve their operating performance.

Expected Results:

1. We expect a declining debt-equity ratio post IPO.
2. We expect the risk exposure to reduce after IPO.
3. We expect increasing value for operating leverage, operating margin, return on assets pre and post initial public offerings

1.7 Scope and Limitation of the Study

We do know that limitation in data exist since not all-industrial groupings are included. Moreover the criteria for selecting firms (both quoted and unquoted) are not randomised. Therefore, the conclusions may be subject to slight modification in order for us to generalise completely.

1.8 Organisation of the Study

The study contains six chapters: Chapter one contains Introduction of the study, Statement of Problem, Research Questions, Research proposition Objective of the study, Significance of the study, Methodology and Scope and Limitation. Chapter two is a Theoretical Framework and Literature review; chapter three is a highlight on the Nigerian Stock Exchange. Chapter four contains Model Specification and

Discussion; chapter five is Data Analysis and Discussion. Finally, chapter six presents the Summary, Conclusion and Recommendations.

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CHAPTER TWO

LITERATURE REVIEW

2.0 Theoretical Framework

A firm seeks quotation on the stock exchange because quotation offers a number of advantages to firms that go public. Other firms remain private even when they have met listing requirements possibly because of some perceived disadvantages of getting quoted. We will review theories on the motives of firms that seek listing. At the same time, we will look out for factors acting as deterrence to going public.

2.1 Adverse Selection Cost and Moral Hazard Theory

IPO underpricing is a cost to initial owner of enterprise. Therefore entrepreneur try to avoid going public. When investors have imperfect information, it is low quality firms that benefit from IPO. This adversely affects the price of IPO (Rock 1986). Many researchers also note that information asymmetries create adverse selection problem in securities market (Akerlof 1970; Greenwald, Stiglitz, and Weiss 1984; and Miyers and Majluf 1984). The problem may be illustrated thus: when there is information asymmetries, outside purchasers of securities will only pay a price that reflects the average value of firms issuing securities. This price may be attractive to low quality firms but unattractive to high quality firms. Therefore high quality firms will not want to issue securities at the going prices. They see IPO as good for only poor quality firms whose profits are about to decline permanently. Brennan and Franks (1995) explain that a new issue is said to be underpriced if the price at which

the security trade in initial dealings exceeds the offer price at which it was sold to investors. Other theoretical explanations have been offered to explain why prices may be less than apparent maximum price achievable (Laughran, Ritter and Rydquist, 1994). Brennan and Franks (1995) argue that IPO underpricing is contrived by directors to ensure over-subscription, and rationing in share allocation process so as to allow owners to discriminate among applicants for shares and reduce the block size of new share- holding. This is done to retain control. To avoid adverse selection, small or young firms with little or no proven track record of performance and low visibility has less likelihood of seeking IPO than large firms with proven track record of performance and high reputation capital. By and large, size and age of a firm have obvious relationship with visibility, proven performance and resilience. Thus young and small firms will negatively impact on listing. Chemmanur and Fulghieri (1994) further explained that public issue of equity, though it entails efficient risk sharing, has large information collection cost due to duplication of investors' efforts. Due to the large cost of information production, small firms will seek venture capitalists for their financial needs though this implies inefficient risk sharing and therefore larger risk premium. Therefore, private financing from venture capitalists is efficient for young little known firms while older firms with more reputational capital will seek public offering of shares. Diamond (1991) also predicts that because of moral hazards, younger firms will prefer to borrow from banks and even older ones will issue debt securities in public market in order to monitor the opportunistic behaviour of controlling shareholders who will want to extract private benefit at the expense of the investing public.

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Because many people see IPO firms as low quality firms whose profits are about to decline permanently, Leland and Pyle (1977) predict that divestment by controlling shareholders who have inside information about a firm could be interpreted by the market as a symptom of unprofitability. To refute the claims of unprofitability, the initial owners who have private information about the firm must be seen to retain a large stake and the stake must be large enough to incur a cost in terms of foregone diversification. Any other behaviour on the part of the controlling shareholder will be seen as non- profitability and therefore will lower the company's value to external shareholders.

We therefore can draw a number of testable implications from adverse selection cost and moral hazard theories:

i. Because of the presence of adverse selection costs, a small firm is less likely to go public because of IPO underpricing.

ii. In the presence of moral hazards, smaller firms will prefer to borrow from banks than going to the market.

iii. Because of high cost of information production and its effect on IPO under-pricing, small and young firms will source for funds from venture capitalists rather than IPO through initial public offerings.

iv. Controlling shareholders divestment and profitability of firms are inversely related.

Therefore sales volume and net profit of firms affect the likelihood of IPO. Operating margin (ROS) and return on asset (ROA) capture the size of a firm and will therefore affect the decision to go public.

$$ROA = \frac{EBITD}{TA}$$

$$ROS = \frac{EBITD}{TR}$$

EBITD = Earnings before interest, tax and depreciation.

TA = Total asset

TR = Total revenue

ROA = Return on asset

ROS = Operating margin

Some empirical works in other countries provide a clue to some of the assertions made in the adverse selection and moral hazard theories. Jain and Kini (1994) documented in the United States that after IPO, a firm experiences a significant decline in operating performance. Moreover, the observed decline in performance is smaller for a firm whose original entrepreneurs retain more equity. Amount divested is inversely associated with the ex-post accounting performance in agreement with the prediction of Leland and Pyle (1977), Jesen and Meckling (1976) and Pagano et al (1996). Inferences from these findings are many:

i. The decline in operating performance post IPO may be an expression of the quality of the firms. Because of the low quality of these firms, profits may be declining permanently and owners may want to re-balance portfolios.

ii. When initial owners retain more equity post IPO, it is an indication that the firm is of a high quality.

iii. Divestment of majority share is an obvious indication of poor quality and lack of performance of a firm. Two patterns of share ownership and divestment

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are therefore discernible among initial owners of firms making initial public offerings.

(a) Firms in which the controlling group keeps a strong financial commitment and demands finance from outside investors. Initial owners sees such firms as having the ability to retain or improve performance post IPO. The entrepreneurs see their firms as high quality firms.

(b) Firms where controlling group divests and does not raise new equity. Since the controlling group is assumed to possess information about the firm, this may be classified as low quality terminal investment. The objective is to divest and diversify to other areas of comparative advantage

Pagano, Panetta and Zingales (1996) draw attention to the Italian experience where they observe that median IPO is twice as big as median potential IPO in terms of sales, employment and total assets. This is an attestation of the fact that size has a likely effect on the decision to go public as predicted by Ritter (1987).

This again implies that smaller firms prefer alternative sources of capital to seeking public quotation while bigger firms with greater sales volume, employee and assets with probably greater profits and better reputation prefer to seek for IPO. However it may also be noted that when existing stockholders are unwilling to relinquish ownership and retain the largest stake, the possibility of innovation capacity building may be diminished when compared to a new management progressive ideas. This may explain the contradiction between the findings Mikkelson, Partch and Shah (1995) and Jain and Kini (1994).

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Jain and Kini (1994) observed that the lowest post IPO profitability are firms where existing stockholders and directors retain the largest stake. This observation is however not statistically significant. Taiwo (1992) observes that small firms are discriminated against in the market for funds due to imperfection associated with size of firms requesting for funds. According to him, imperfections which have a differential impact on small firms are those associated with information, transaction cost and risk assessment. He observes that most indigenous firms are young; they do not possess sophisticated trading records over time. A track record of sustainable profitability could not be established over-time. Taiwo (1992) set forth-other reasons deterring initial public offering in Nigeria as including the fear of losing control. Alile and Anao (1986) draw attention to the aversion of indigenous entrepreneurs to going public for fear of losing control. Second-tier securities market was created to cater for firms, which could not meet listing requirements on the main exchange list. Emenuga (1993) observes a rise in the number of listed firms without a commensurate growth in capitalisation. This may imply that neither divestment nor the need for capital informs IPOs in Nigeria.

2.2 Administrative Expenses

Costs of IPOs are both implicit and explicit. For example, IPO underpricing is an implicit cost associated to the decision to go public. Registration fees,underwriting fees, cost of advertising, administration and other professional fees are explicit outlay.

IPO. firms will have to consider the yearly outlay on auditing, certification and dissemination of accounting information. Some of the costs are variable and others are fixed costs, which do not increase proportionately with the size of IPO but weigh

more on small firms (Ritter 1987). The likelihood for IPO is higher then for bigger firms than for small firms because of the presence of large fixed cost. Pagan et al (1996) observes that though listing costs in Italy is limited, the other often ignored cost of listing include implicit cost associated with higher visibility to tax and legal authorities. Moreover, listing forces a firm to have its account certified externally. It increases the cost of keeping a parallel account whose cost is prohibitive and therefore acts as a deterrent to tapping public market for equity financing.

2.3 Loss of Confidentiality:

Some firms have sensitive information. Such firms are less willing to expose such information to the public for fear of spill over to competitors. Disclosure rule of stock exchange may force a firm to expose its information on R & D and marketing strategy. This may reduce firm's competitive advantages. Campbell (1979) sees confidentiality as deterrence to getting funded in the market. It also reduces the scope for tax evasion and avoidance. Yasha (1995) also showed that sensitive R&D might force a firm into a bilateral and exclusive relationship with lenders in order to avoid information a spill over to competitors. A testable implication is that sensitive R&D may force a firm into bilateral and exclusive relationship with lenders. In other words high technology firms with sensitive R&D are less likely to go public. In their analysis of British evidence Mayer and Alexander (1991) note that public firms are concentrated in sectors with comparatively advanced technology contrary to what campbell (1979) and Yosha (1997) predicted.

2.4 Overcoming Borrowing Constraints:

A growing firm in a growing market has a need for more funds, which can be soured either through the banks or the securities market. Securities markets are alternative or supplementary sources of funds for firms with substantial investment outlay. Banks are unable or unwilling to provide the needed funds without a substantial increase in interest rates in the presence of information asymmetries. Moreover the leverage ratios for such firms are substantial.

A testable implication is that firms with high leverage will seek for funds in the market either to supplement or as alternative to bank lending. Secondly, firms will invest more post IPO and will expectedly reduce leverage and pay out less post IPO. Pagano et at (1996) used CAPEX as a proxy for demand for funds. CAPEX is lagged level of investment measured as capital expenditures over end of year net property plant and equipment.

$$CAPEX = \frac{Ec}{Np + Nq}$$

Ec = Capital expenditures

Np = End of year net property

Nq = End of year net equipment

Increasing CAPEX will indicate a growing need for funds for capital investment. The degree of leverage is measured thus:

$$LD = \frac{DT}{DT + EQ}$$

LD = degree of leverage

DT = Total Debt

EQ = Equity.

CAPEX and the degree of leverage are expected to have positive impact on the likelihood of IPO, since highly levered firms with growing capital expenditures will most likely face borrowing constraints. Mayer and Alexander (1991) compared the characteristics and performance of 544 British quoted firms with 56 large firms that stayed private from 1980 to 1987. The study revealed that IPO firms invest more, grow more rapidly and pay out more dividends than private firms. Moreover, they raise more equity finance, but use it to purchase stakes in other firms rather than for direct investment. Rydquist and Hogholm (1994) studied the change in ownership, leverage and size in 164 family owned firms that went public in Sweden in the period 1970 - 1991. In their report, most firms have not used IPO as opportunity to reduce leverage or finance growth. The report contradicts the self-reported motive in IPO prospective. In the Swedish data, 97% of cases in which a motivation was stated, IPO was presented as aiming at firm financing whereas only 14% of the prospectuses stated the aim of re-balancing portfolio of initial owners. The need to finance investment and growth is the most commonly quoted self-reported information in Italy. Pagano et al (1996) show that IPO firms did raise new equity but it was not mainly directed at financing investment growth.

2.5 Greater bargaining power with banks:

A bank charges monopoly rent if it has access to privileges information about credit worthiness of a firm. Rajan (1992) highlighted that when such a firm gains access to stock market and disseminate information to the generality of investors, the firm elicit outside competition to its lender, reduce or eliminate such monopoly rent and ensures

a lower cost of capital and a larger supply of external funds. We therefore conclude that IPO should appeal more to firms facing high cost of bank borrowing and high concentration of credit sources. Pagano et al (1996) measured relative cost of capital (RCC) thus:

$$RCC = \frac{(1 + r_{it})}{(1 + \bar{r})}$$

RCC = relative cost of capital

$(1 + r_{it})$ = interest factor charge to firms

$(1 + \bar{r})$ = the average interest factor

Herfindahl index is used to measures concentration of firm credit sources. We expect both variables (RCC and Herfindah Index) to have a positive impact on the likelihood of IPO. In other words the higher the RCC and Herfindahl index, the greater the likelihood of IPO. Empirical result shows that the improved relationship with bank resulted from greater transparency of accounting information and greater flexibility in financing choices (Pagano et al 1996).

2.6 Risk Diversification

A private firm goes public to increase the scope of diversification by the entrepreneur. Obstafeld (1994) sees quotation in a stock exchange as a vehicle for diversifying risk. An entrepreneur is able to diversify into higher return project. Diversification is achieved directly by divesting from the firm and reinvesting in other assets or indirectly by having the IPO firm raise fresh equity capital and acquiring stakes in other firm where he does not posses comparative advantage. One testable implication is that lower cost of diversification will attract entrepreneur to stock market. An

illiquid market will lower the benefits an entrepreneur expects from giving up ownership of a stake in a firm for a portfolio of financial assets (Pagano,1993). Pagano(1996) confirms that portfolio diversification is a primary motive for IPO. It was observed that divestment of large shareholder is mostly concentrated at IPO.

2.7 Stock Market Discipline

Agency problem is reduced when shares are quoted on the stock exchange. Jenson and Murphy (1990) show that efficient stock market helps to mitigate the principal agent problem as it makes it easier to tie managers' compensation to stock performance. This link helps to align the interest of managers and owners. The market imposes discipline on corporate managers as share prices react to right and wrong judgements in firms' investment decision. One source of market discipline is the fear of raiders. Takeover threat induces managers to maximise a firm's equity. Shleifer and Vishny (1986) argue that for discipline to take place, it is required that potential raider has sufficiently large state in the firm. In addition, Homston and Tirola (1993) point out that shareholders of a public company can use information reflected in stock prices to design more efficient compensation scheme for their managers by indexing salaries to stock prices or by offering stock options.

One testable implication is that ex-post operating performance post IPO should increase since information provided by the stock market can be used to discipline managers. Moreover, it is expected that salaries and benefits of management staff should be higher post IPO. Rydquist and Hogholm (1994) state that 38 percent of the IPO prospectus mentioned incentives to employees as the main motive for IPO.

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2.8 Liquidity

When shares of quoted firms are traded on an organised exchange, transaction cost is cheaper for small shareholders that want to trade on short notice. Shares of unquoted firms can be traded only through informal searching for a counterpart at a considerable cost to the initiating party. If initial owners of a firm want to sell to dispersed shareholders, they have an inducement to go public. If a firm stays unquoted, to minimise liquidity cost, it must sell stakes to a few large shareholders that will by and large demand for monitoring role in the firm. Pagano and Roell (1995) show that as a result the initial owners may have to accept over monitoring if they stay private. The model predicts a positive correlation between the likelihood of IPO and the scale of subsequent investment.

2.9 Investors Recognition

Investors prefer a portfolio mix that contains securities of existing firms that have acquired reputation overtime. Listing on a major exchange can act as an advertisement for firms. Merton (1987) captures this in capital asset pricing model with incomplete information showing that prices are higher the greater the number of investors who are aware of a firms securities. Kadlec and McConnel (1994) observed that when firms already listed elsewhere announce their decision to list also in New York, their stock yield five (5) percent abnormal returns on the average. One prediction here is that the likelihood of IPO is affected by corporate image. Secondly; corporate image through advertisement will boost stock prices. Diamond (1991) and

chemmanur and Fulghieri (1994) also observe that small firms find it difficult to establish reputation and sell equity without facing large adverse selection cost.

2.10 Change of control

Zingales (1995a) points out that going public could be viewed as an optimum first step in the process of selling a firm. According to him, selling off a minority stake to dispersed shareholders may increase the amount of surplus the initial owner can extract from future buyers of the majority stake thereby increasing the total proceeds the initial entrepreneur can fetch selling the firm. If this is an important motivation behind IPO, we expect a high incidence of control transfer after IPO as controlling shareholders have incentive to extract private benefit at the expense of minority shareholders. According to Rydquist ad Hogholm (1994) IPOs in Sweden are more likely for older firms; often by owners who want to divest. This is consistent with Zingales (1995a) where in 59 companies the initial entrepreneurs sold out all their shares within five years post IPO.

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2.11 Windows of opportunity

Stocks are often mispriced (Delong et al 1990) During period of overvaluation in an industry firms within the industry, which realise this have incentive to go public. Windows of Opportunity hypothesis model and tested by Rajan and Servaes (1995) is consistent with international time series evidence in the 1980s (Langhram, Ritter and Rydquist 1994). A testable implication is that when the market for comparable firms is bullish, firms in the same industries are more likely to go public. It is also consistent with low long-run returns (Ritter, 1991, Loughran and Ritter 1995).

Pagano et al (1996) measured the price of IPO on the market by median ratio of the market to Book value (MTB) of firms in the same industries and found a strong correlation between the median ratio of market to book and the probability of IPO. Public offerings tend to be higher at period of high market to book ratio of any particular industry. Lerner (1994) found that biotechnology firms go public near the peak of Biotech equity valuation. This means that IPO is strictly time to coincide with industrial boom in stock valuation. The dismal post IPO profitability is consistent with this claim since such boom may not be sustained permanently. For example Ritter (1995) documented a strong under performance of IPO firms three years and five years post IPO.

Pagano, Panetta and Zingales (1996) employed the probit model to investigate factors that affect the likelihood of IPO. They employed the model

$$\Pr(IPO_{it} = 1) = F(\alpha 1\ SIZE_{it} + \alpha 2\ CAPEX_{it} + \alpha 3\ GROWTH_{it} + \alpha 4\ ROA_{it} + \alpha 5\ LEVERAGE_{it} + \alpha 6\ MTB_{it} + \alpha 7\ RCC_{it} + \alpha 8\ HERFINOAHLit + \gamma_t YEAR_t)$$

IPO_{it} is a variable that equals 0 if company I stays private in period t and equal 1 if it goes public. F(.) is the commutative distribution function of a standard normal variable, and $YEAR_t$ is a calendar year dummy. In their conclusions, size is an important determinant of IPO. A one standard deviation in the logarithm of sales increases the probability of an IPO by one third of a percent age point. The two variables that measure a firms financing need – investment and growth – increase the probability of listing. The coefficients of both variables are not statistically significant at 0.05 but growth is only significant at the 10% level.

Proxies of cost and availability of credit do not have much explanatory power. Cost of bank credit and a firms leverage have a negative impact on the likelihood of

an IPO. But neither is statistically significant at 10% level. Concentration of bank credit appeared to increase the likelihood of IPO, but also this effect is not statistically significant. Finally, the industrial market-to-book ratio appears to be the most significant determinant of the probability of IPO.

In the same study Pagano, Panetta and Zingales (1996) investigated the determinant of the decision to go public by estimating fixed-effects regressions in which the effect of the decision to go public s captured by dummy variables for the year of the IPO and the three subsequent years.

For each of the variable use, the specification is:

$$Y_i = \alpha + \sum_{j=1}^{3} \beta_{jIPO_{t-j}} + \beta_4 IPO_{t-n} + \sum_{j=0}^{3} \gamma_j QUOT_{t-j} + \mu_i + \delta_t + \epsilon_{it}$$

whereμ_i and δ_t are respectively a firm specific and calendar year specific effect. IPO_{t-j} are dummy variables equal to 1 if year t-j was IPO year, IPO_{t-n} is a dummy variable equal to 1 if the IPO took place more than 3 years before. $QUOT_{t-j}$ are dummy variables equal to 1 if company i satisfies the listing requirements in year t –j. Using the fixed effect regression model, they reported that:

i. Profitability declines after IPO. This according to Degeory and Zechiauser (1993) is not surprising since entrepreneur may time their issues to coincide with unusually high profitability or they may engage in window dressing of their corporate account at the time of IPO. In other words, an explanation for the permanent drop in profitability has to do with the accounting changes brought about by the decision to go public because at these time firms usually present inflated pictures of the value of their assets.

ii. The decision to go public has a negative impact on capital expenditure.

iii. Investment in financial assets rises temporarily at the time of IPO, as new IPO temporarily invest the abnormal inflow of liquidity from IPO in financial assets.

iv. A report of the drop in the relative cost of credit post IPO.

2:12 Corporate Governance

Corporate governance impacts on financing choices of a firm. Obligations of a firm depend on the structure of its governance. The obligations are discharged in pecuniary terms through money payments. Pecuniary discharge by a firm constitutes a cost to management/owners. The entrepreneur will therefore act to change their investment behaviour in order to minimise such payments. They do this by altering the structure of governance.

Corporate governance according to Elmeskore (1995) comprises the relationships between all institutions and individuals directly or indirectly involved in decision making in a firm. Management theories see a firm as a coalition of shareholders/owners, managers, lenders, suppliers, customers, employees and tax collectors. The conflicting interests of the different stakeholders in a firm must be resolved if the firm must survive. The resolution of conflicts is often done to the disadvantage of weaker members of the coalition. Management of a firm acting on behalf of owners constitute the most important member of the coalition because management takes decisions on investment, expansion, promotion, appointment and has access to information (Koutsoyiannis, 1982). Demirnguc-Kunt and Macksimovic (1996) observed conflict of interests between the firm and its customers and suppliers

and between various classes of investors in a firm. Because of the conflicting interest, owners/managers of a firm may be induced to harm the interest of other members of the coalition. Such opportunistic behaviour can be anticipated. It makes it difficult for a firm to obtain funding. One possible prediction in the modelling of conflict of interest in Barnerar, Haugen and Senbet (1985) Jensen and Meekling (1976) is that debt financing increases the incentive of initial owners of a firm to act opportunistically or to otherwise harm creditors, customers and suppliers. By and large, the conflict is between owners of fixed rate debt capital who have contractual claims on the firm and those who have equity share ownership. Because of the opportunistic behaviour of owners and their incentive to harm contractually fixed income owners, a firms ability to get funding is inhibited and the alternative is obtaining fund through equity issues in the market.

2.13 Debt- Equity Mix

Many have argued in corporate finance literature over the existence or non-existence of optimal level of debt- equity mix in a firm. Modigliani and Miller (1958) (M-M here after) argued that there is no such thing as optimal debt-equity ratio for a rational investor. It is argued that firms being rational, will push investment to the point where marginal yields on physical assets equals market rate of interest. The model is specified as:

$$S = Pk + Pk - r\frac{D_i}{S_i}$$

where: S = expected rate of return or yield

Pk = Capitalisation rate

r = interest charged

D_i = market value of debt

S_i = Market valve of common share in a company

It is argued that stockholders will exploit investment opportunity if and only if the rate of return on investment say 'P', is as large as or larger than Pk and will be completely unaltered by the type of securities use to finance the investment (Modigliani, 1988, Miller 1988).

M-M theory describes the circumstances under which the composition of firms' liabilities is completely irrelevant to the cost of obtaining external funding. In other words, Hagin (1979) observed M-M hypothesis as stating that market pricing mechanism will adjust a firms cost of capital so as to minimise the importance of the firms internal decision regarding capital structure.

Many theoretical works were formulated to explain the determination of debt-equity ratio for a firm (Bhattacharya 1988; Lyon 1992; Jaramillo et al, 1993) Hite (1977) shows that an increase in the financial leverage of a firm will reduce users cost of capital. Sundararajan (1987) argued that debt-equity ratio is important because it affects overall cost of capital to the firm. The cost of capital influences fixed investment. Overall cost of capital expressed as a weighted aggregate of the opportunity cost of bank debt and of equity. The weights depend on debt-equity ratio. Moreover, a firm may invest to reduce the cost of production thereby increasing its profit. Sundararajan (1987) postulates that a firm strives to obtain debt-equity mix that minimises cost of capital. His specification for the desired level of average debt-equity ratio is:

$$DE^* = d^* (iu - i, ii)$$

where DE^* = desired debt-equity ratio

d* = non linear function of the interest rate subsidy and inflation

iu = nominal interest rate in the unregulated market

i = weighted average of domestic and foreign interest rates

ii = rate of inflation

The basic proposition is that the desired debt-equity ratio will be positively related to the implicit interest rate subsidy from the regulated market and the level of inflation. This is because higher rate of inflation act to reduce the real rate of return on real balances or on any other savings instruments bearing a fixed nominal return. An increase in interest subsidy will reduce the cost of debt relative to the cost of equity. Omole and Falokun (1999) observed that there are other factors affecting leverage other than interest rate subsidy and rate of inflation. For example corporate income tax assessments differ for debt, retained earnings and dividends. Other market imperfections in LDCS also impact on the desired debt-equity profile. Such distortations as agency cost, information a symmetries, differential tax, bankruptcy, moral hazards and transaction cost.

Boyd and Smith (1996) argued that an entrepreneur would raise external funding in the lowest cost way. The cost of external funding depends on a number of factors including the level of market interest rates and the existence of various subsidies implicit in things like government credit, interest subsidy or loan guarantee. Boyd and Smith (1996) suggest that through these channels government policy can be made to affect the level of activities in equity market. Government macro-economic activities can influence the total cost of capital. Monetary and fiscal policies and management can affect the cost of debt relative to equity financing.

Cost of capital is the minimum yield of an investment acceptable to the shareholders. The minimum yield will depend on interest payment and return to equity. Annual interest payment and timing of principal repayment is crucial to overall cost of debt. Therefore the rate of interest on debt financing is positively associated to growth of equity market. Higher rate of interest makes equity financing relatively more attractive. On the other hand the cost of equity financing – return on equity – depends on capital gains and dividends payments. Therefore, tax treatment of interest cost, capital gains and dividends will affect the relative attractiveness of debt and equity financing. Differential tax code for debt and equity is important since interest is tax deductible while dividend is not. Increase in the rate of dividends and capital gains tax therefore will retard the growth of equity market. The use of tax instruments in promoting the growth of emerging capital market assumes more importance as investment capital becomes more internationally mobile and more sensitive to the investment climate in the most country. Removal of high level of taxation stimulates financial intermediction and investment particularly when the measures are conceived to be a permanent policy charge (Chamley, 1991). High tax rate negatively affects investment and acts, as investment retardant to the instrument for which the tax burdens is discriminatory and heavier. An increase in dividend and capital gains tax will shift preference to debt funding. Multiple taxation-corporate income and dividend – will amount to retarding the growth of equity relative to debt. An integration of corporate income tax and personal income tax as well as a reduction on withholding tax on dividend will shift preference to equity finance. The tax burden becomes more when it is levied on normal rather than rence on real income (Inanga and Emenuga 1996). Moreover, the level of debt-equity ratio determines the

level of risk exposure. The financial leverage risk will affect the solvency and risk of bankruptcy and therefore the ability to obtain debt finance. Bankruptcy costs are incurred when entrepreneur cannot make contractual payment to creditors. Contractual payments called for by debt financing are not contingent on a firm's performance unlike dividend payments which are subject to declaration by board of directors. Therefore the composition of a firms debt and equity affect the probability of bankruptcy. Moreover, highly livered firms have low credit rating and therefore high credit risk. This reduces their chances of getting financed by institutional investors. Demirguc-Kunt and maksimovic (1996) noted that many investment funds and mutual funds are prohibited from investing in companies whose stock do not trade on a recognised exchange. Moreover, corporate debt issuers are often required in many countries to show their credit rating before getting funded. Low credit rating due mainly to high leverage ratio deters debt financing except where such debt are guaranteed from either the government or other more credit worthy institutions.

The problem of maintaining control is also very crucial to determinant of whether to go for debt or equity financing. Debt issue may be preferred to equity market funding in order to retain control. Firms may also issue shares with non vating right such as preference shares or different grades of equity shares with progressively reduced rights to vote.

Cost of equity depends on the price of equity and return to equity. The higher the price- earning multiple (P-E ratio) the greater the supply of equity. Therefore the supply of equity tends to the greater during period of over-valuation.

Other factor that may affect the size of debt relative to equity financing in an economy is the differences in transaction cost of debt and equity. This includes fees

for investment banking services, reporting requirements, payment to various professionals and regulatory bodies. However issuance cost may be tax deductible. Therefore, issuance cost may be investment retardant for either debt or equity depending on which is discriminate against.

Finally, when entrepreneur can finance project in equity market, the result is a decline in debt equity ratio; larger size firms; many risky projects become attractive to an entrepreneur, projects that are unprofitable when financed through debts become profitable; better information aggregation; investors and creditors are attracted because of lower monitoring: and lower cost of funds for the firms.

Koutsoyianiss (1983) observed that managers desire job securities He attaches a disutility to the risk of being dismissed. Managers become risk avoiders as they adopt prudential financial policy. Therefore, three ratios are critical to a prudential financial policy:

i. The leverage or debt ratio, ii. Liquidity ratio, and iii. Retention ratio.

The leverage or debt ratio is defined as the ratio of debt to gross value of total assets.

$$\text{Leverage} = \frac{\text{value of debt}}{\text{Total asset}} = \frac{D}{A}$$

The manager minimises leverage for fear of insolvency and bankruptcy which my arise from interest and loan repayment. A high leverage ratio is a disutility to managers.

ii. Liquidity ratio defined as the ratio of liquid asset to total asset:

$$\text{Liquidity} = \frac{\text{Liquid asset}}{\text{Total asset}} = \frac{L}{A}$$

Optimal liquidity ratio is adopted by management to avoid bankruptcy and raiders. High level of liquidity may attract raiders

iii. Retention ration defined as the ratio of retained profits (net of interest on debt) to total profits

$$RR = \frac{\text{Profit retained}}{\text{Total profit}} = \frac{Pr}{Pt}$$

Retention ratio, a major source of capital growth is affected by interest on debt. However, a too high level of undistributed profit may lead to shareholders dissatisfaction and loss of share valve and possibly take over by raiders.

Non availability of efficient functioning equity market means a firm will depend on inside equity, trade credit and bank borrowing and possibly retain earns. The likelihood is a suboptimally high debt – equity ratio. Incentive to renege on promises becomes high. Therefore investment funds will be scarce and the way out will be to go to the market to source for funds.

CHAPTER THREE

HIGHLIGHT ON NIGERIAN CAPITAL MARKET

3.0 Introduction

The Nigerian financial system is made up of the banks, non-bank financial intermediaries and securities market. The system is characterised as either money market or capital market. Money market deals in short-term funds and securities. Short-term securities are usually redeemable in less than one year. Money market securities include treasury bills, treasury certificates, negotiable certificates of deposits and commercial papers.

Capital markets deals in intermediate and long-term funds and securities. The gestation period for long-term securities is usually more than one year. Capital market securities include longer-term loans, mortgage bonds, preference stocks, industrial loans, ordinary shares, Federal Government stock and bonds.

In Nigeria, the capital market is made up of both the new issues (primary) market and market for the sale of old issues (secondary market). By and large, securities in the Nigerian capital market are of two types: debt securities and equity securities. The debt securities are Federal government development stock, industrial loans, preference stock and bonds. Equity securities are ordinary shares that give residual claim to holders. Ordinary shares impose higher liabilities on holders. The transfer of funds from savers to fund users is facilitated in the capital market through an institutional arrangement involving Securities and Exchange Commission (NSEC), the Nigerian Stock Exchange (NSE), operators and investors.

Capital market serves a number of useful economic functions. It facilitates financial intermediation and mobilisation of investible funds; it is a mechanism for exchanging securities at mutually satisfactory prices; it creates liquidity for investors; it is a mechanism for ascertaining security prices; a means of efficiently trading in securities; allocates and rations a nations real and financial resources; it is an important economic barometer; a means of determining current cost of capital; and a mechanism for broadening ownership base.

In Nigeria, capital market has been used to promote small and medium scale industries through the creation of Second-tier Securities market (SSM); it provide facilities for securitisation by making domestic debt negotiable and discountable through the Central Bank of Nigeria (CBN) thereby providing liquidity to owners of government bonds; it is a platform for commercialisation and privatisation of government enterprises; and a means of internationalising the capital market. The names, share prices and other information on all quoted firms are linked to Reuters International information system in order to disseminate relevant market information to subscribers.

3.1 The Nigerian Securities and Exchange Commission

The Nigerian Securities and Exchange Commission was set up under NSEC decree 1979 as a regulatory body in the capital market for orderly transaction in securities. It is primarily meant to protect investors. NSEC does valuation; allotment; surveillance; and registration of securities and institutions involved in securities dealings.

Principally its role is promoting professionalism in securities dealings. NSEC has promoted programmes to educate Nigerians on the intricacies of securities

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dealings. It also provides informational services. NSEC appraises the operational performance of both quoted and unquoted firms in Nigeria annually and makes the information available to the investing public.

3.2 The Nigerian Stock Exchange

The Nigerian Stock Exchange is a non-profit making organisation limited by guarantee and owned by 135 shareholders. Owners of the NSE include financial institutions, stockbrokers and individuals. NSE has a Council and a President, Chairman and Board of Directors who are elected at each annual general meeting by members of the exchange. The council is responsible for policy making. The Director General and his management team administer the day-to-day running of the affairs of the exchange. General discipline in the market and its orderly conduct is the responsibility of the NSE. It is also responsible for listing and delisting companies under its control.

Currently the NSE has six trading floors and a new one has been opened at Abuja. The exchange floors are in Lagos, Ibadan, Kaduna, Kano, Onitsha,and Port-Harcourt. The Lagos Stock Exchange, which is the first trading floor was opened in 1961 with only 19 securities. There are 60 issuing houses, over 75 stock broking houses, over 100 floor dealers, several registrars and a computerised communication system.

3.3 Membership of the Nigerian Stock Exchange

NSE has ordinary and dealing members. Ordinary members are individuals and institutions that have acquired at least five (5) shares of ₦20 each of the issued-shared

capital of the exchange and have been admitted to the register of members. A dealing member is an individual or institution admitted to ordinary membership of the exchange and also licensed by the council of the exchange to transact business in stocks, shares, debentures, bonds and other specified securities on the floor of the exchange. He must undertake to be subject to the rules and regulations of the exchange. Dealing clerks represent dealing members on the floor of the exchange.

3.4 Objectives of the Nigerian Stock Exchange

The objectives of the Nigerian Stock Exchange as stated in its memorandum of association include:

a. Creating appropriate mechanism for capital formation and efficient allocation of resources.

b. Providing strategies for financing projects with long-term gestation period

c. Maintaining discipline in capital market

d. Broadening share-ownership practice

e. Maintaining fair prices for securities

The stock exchange market is said to be the only perfect type of organised market for many reasons. The commodities traded on it have little or no carrying costs; they are imperishable and entirely standardised; trading is organised in the sense that only the dealing members are allowed to trade on its floor on behalf of their numerous clients; there are rules and regulations to guide the conduct of all the operators; it enables owners of securities to convert them into cash quickly and without inconveniences and also at a comparatively moderate cost.

By evaluating the securities, it acts as a barometer of the state of health of the individual firms. Market index or average serves as an important tool for measuring the overall health of the stock market. By and large stock market indices are important economic indicators. NSE ensures that quoted firms disclose the fullest information in their annual reports and accounts, submit quarterly returns and keep within the status and requirements of the exchange in the publication of the their annual reports and payment of benefits in the form of dividends to shareholders (NSE 1980).

All dealing members of the NSE must deposit the sum of ₦100, 000 or its equivalent in an acceptable security before being issued a licence to deal. Thereafter he must make an annual subscription of ₦5, 000.

3.5 The Evolution of the Nigerian Stock Exchange

The Nigerian Stock Market has evolved overtime. However, stock market development indices show that the Nigerian market development is rather slow. Dike (1998) observed that the Nigerian stock market remains presently unusually small when compared to the stock markets in other LDCs.

Appraisal of the evolution of a nation's stock market involves looking at stock market development variables described in Demirgic-Kunt and Levine (1996). Data for developing countries was picked from the International Finance Corporations emerging market data base while for the industrialised countries, the data was source from Morgan Stanley Capital International and International Monetary Fund

publications (various issues). The data covered the period 1986 to 1993 for forty-four countries.

Market size, market liquidity, market concentration, volatility, institutional development and international market integration are found to be positively associated to stock market development. Insufficient stock market development means that investors and entrepreneur face insufficient opportunities for the diversification of risk portfolios. Insufficient opportunities for diversification impacts negatively on savings agglomeration. The Nigerian stock market is classified among the emerging stock markets of the world. Others in this category include the Republic of Korea, South Africa, Zimbabwe, Turkey, and Singapore among other markets in the LDCs. In terms of stock market development indices, emerging stock markets lag considerably behind stock markets in industrialised countries including the United States, Japan and United Kingdom.

Stock market size – capitalisation and number of listed firms – shows that between 1986 – 1993, not much capital formation was done through the NSE. Market capitalisation measures the value of listed stock in an exchange relative to GDP. Capitalisation can increase through increased primary issues or secondary issues by existing firms for the purpose of expansion or modernisation. Capitalisation also increases when stock prices appreciate in value.

Between 1986-'93, capitalisation of the NSE averaged 4%. During the same period, other emerging stock markets such as Zimbabwe, South Africa and Turkey had capitalisation of 18%, 154% and 8% respectively. Market capitalisation for the same period for U.S.A., Japan, United Kingdom were 54%, 108%, and92% respectively. In terms of ranking of market capitalisation ratio, the 1986-'93 data

shows that Nigeria stock Exchange ranked the least out of 41 countries. The Nigeria stock market capitalisation for 1990, 1991, 2992, 1993 and 1994 are 4.2%, 5.8%, 3.8%, 3.2%, and 6.2% respectively. The dollar value for NSE capitalisation for 1990, 1991, 1992, 1993, 1994 and 1995 are $1.4b, $1.9b, $1.2b, $1.0b, $2.7b and $2.0b respectively. For the same period, India had $38.6b, $47.7b, $65.1b, $98.0b, $127.5b, 127.2b respectively while South Africa had (for the same period) $137.5b $168.5b, $103.5b, $171.9b, $225.0b, and $280.5b respectively.

Between 1986 – '93, the average number of listed firms in the Nigerian stock exchange was 127. With an annual growth rate of 8%, Nigeria ranked 33rd out of 43 economics in terms of listing. For the same period, South Africa, Zimbabwe and the Republic of Korea listed 700, 57, and 576 companies, respectively. Our comparative analysis shows that the financial base of the NSE was insignificant when compared to the GDP and other emerging stock markets. The World Bank held a similar opinion in 1983 when it stated that out of approximately 5,000 private companies employing more than 10 people in Nigeria, less than 100 were listed on the Nigerian stock exchange.

The number of listed Nigerian firms for 1990, 1991, 1992, 1993, 1994 and 1995 were 131, 142, 153, 174, 177 and 181 respectively. These figures are for both the first and second-tier markets. Low market capitalisation means that the market is narrow; not much capital formation is done through the exchange; and low risk diversification ability. Ability to diversify risk is positively associated to savings mobilisation (Pagano, 1993).

Adeyemi (1998) listed a number of factors that account for lack of interest by Nigerian companies to seek quotation on the Nigerian stock exchange. It include high

cost of public quotation; reluctance of Nigerian companies to dilute ownership and control; the interest rate structure in the past which favoured debt financing over equity financing; and stringent requirement for listing

Owners of risk portfolios need flexibility in investment decisions. Flexibility in investment decision enables investors to alter the sizes and composition of their financial assets in line with their risk preferences. Thus, liquidity of the stock market enables an investor to maximise his investment yield. Stock market liquidity is an important measure of stock market development. Liquidity measures the ability to buy or sell securities at prices fairly well known in advance. A comprehensive liquidity assessment will include the cost of transaction – both pecuniary and non-pecuniary. Therefore, payments to agents; ability to find counter part in trade; waiting time for settlement; various taxes; and other surcharges(official and unofficial) are integral part of the cost investors and agents in the capital market must pay. Transaction cost impacts on market liquidity. Illiquidity makes market inactive. In a liquid market, quoted firms have more access to debt and equity (new issues). It also means that markets are able to allocate resources to high return long-term projects thereby contributing to economic growth; it impacts positively on savings agglomeration; shares traded on liquid market are easily accepted as collateral for bank lending. When a market is illiquid, it affects its allocative efficiency; financial asset holders find it difficult moving in and out of the market at prices reasonably well known in advance; it become unattractive to dispose of the few financial assets at the disposal of investors; and investment in financial assets become risky.

The two empirical measures of stock market liquidity are:

i. Total value traded relative to GDP. A highly capitalised stock market with small total value traded relative to GDP indicates low financial asset trading relative to the size of the economy.

ii. Market turnover compares total value traded to market capitalisation. High market turnover ratio is an expression of high market activity relative to the size of the market.

Measures of liquidity have low values in the Nigerian stock market. The total value traded relative to GDP for the Nigerian stock market averaged less than 1% for 1986 to 1993. The ratio ranks the least among 41 economies in advanced and developing countries. For African countries, South Africa had 8% with a rank of 21 out of 41 countries; and Zimbabwe had average liquidity of 1% with a rank of 31. The 1986 to 1993 data also show an average turnover ratio of 1% with a rank of 41. The turnover for the stock markets for the year 1996 were 2.4%, for Nigeria, 10% for Botswana, 7.6% for Zimbabwe and 4.6% for Mauritius. Korea and Germany largely reflecting massive trading had an annual average of turnover of 93% and 147% respectively from 1986 to 1993.

The low liquidity in Nigeria may be attributed to the high transaction costs; share ownership structure; the culture of buying and holding; paucity of securities; inadequate infrastructures facilities; low public awareness; and market segmentation.

Market concentration affects liquidity of the stock market. High market concentration is a mark of stock market under development. Concentration measures the share of market capitalisation held by the ten largest stocks. The United State and Japan have very low concentration: the ten largest stock accounted for less than 20% of market capitalisation during the period 1986 –'93. In Nigeria for the same period,

the concentration averaged 51%, indicating that concentration in Nigeria is two times larger than those in the United States and Japan. Nigeria ranked 21 out of 26 countries in terms of market concentration.

Regulatory and institutional characteristics of securities markets are vital to stock market development. Such institutional environment includes: the degree of restrictions on dividends and capital repatriation; quality of firms disclosures; whether or not price-earning multiples are published annually and are of international standards; whether or not accounting standards are adequate; the presence of securities and exchange commission; quality of investors protection law; and trading costs.

The Nigerian Securities and Exchange Commission (NSEC) is the apex regulatory body in the Nigeria capital market. NSEC was established in 1979 to replace the Capital Issues Commission (CIC). The role of NSEC is to monitor, supervise and ensures compliance to market rules and standards- standards that promote transparency in the conduct of securities dealings- thereby gaining investors' confidence. Transparency enhances market integrity, increases investors confidence that the market is free from potential manipulations and fraud. Investors could observe current prices and monitor quality of execution received from their brokers.

Since its inception, NSEC has performed its regulatory and supervisory role over the market. In 1993, its role in pricing and allotment was transferred to the market operators (Issuing houses and stockbrokers) who are better able to approximate the true value of securities. NSEC was criticised for handing dow prices that do not reflect the intrinsic values of the shares. Many analysts h observed that NSEC has been effective in its regulatory and supervisory functions

since its inception. The argument has been that there have not been cases of fraud or malpractice in stock market operations in Nigeria. It is true that insider abuse and manipulations are rare in the market. But we will not fail to point out the documentation of Ebhodaghe (1997) concerning two quoted firms in Nigeria. He disclosed that African Continental Bank (A.C.B.) and Co-operative and Commerce Bank (CCB) were distressed for quite sometimes and NSEC and NSE were not aware of their poor financial conditions and were allowed to make secondary issues even at a premium in the capital market. Inferences from these observations are obvious and can be far reacting.

Ebhodaghe (1997) also reported that by 1994, of the 301 registered capital market operators, seventeen (17) were found to be distressed. Capital market distress manifest itself in many ways including inability to remit subscription monies to issuers; non refund of over subscription to investors; inability to purchase securities for clients even when they are paid for; and non remittance of money to clients from the proceeds of sales of their securities. In 1998, NSEC approved increases in the capital base of capital market operators: Issuing Houses from N5m to N40m; Portfolio managers from N2.5m to 10m; corporate Advisers from N0.5m to N2m; and individual advisers N100, 000. Currently these increases are still minimal for liquidity and solvency of the operators. The current wave of liberalisation and globalisation and the on going privatisation is likely to task the finances and operations of market operators. Therefore the capital base must be enhanced. A possible way out is joint partnership with foreign market operators. Apart from helping to improve the capital base of operators, such partnership will foster improved financing technology and quality personnel for service delivery. Globalisation of

finance will certainly task the intellectual and operational capabilities of the market promoters.

Market barriers affect market integration and create segmentation in securities market. Barriers may be created by withholding tax on dividends and capital gains tax; inadequate information about existing firms; restriction of share ownership; high cost of transaction; and other macro economic conditions, which are hostile to business environment. Market segmentation creates differential risk pricing across borders or across different exchanges in the same country; it affects inflow of foreign capital; it stifles technological transfer and innovation; it creates monopoly rent for market operators; and it may result in general market inefficiency.

In Nigeria, before the indigenisation of business enterprises in 1972, foreigners had unrestricted participation in businesses. The Nigerian market was laissez-fair in scope and content. The indegenisation Decree of 1972 (amended and reinforced in 1977) restricted the scope of foreign participation and interest to 40% equity in listed securities. The indigenisation legislation of 1989 featured amendment to accommodate larger foreign interest in capital market. The amendment retains the limit of 40% foreign participation only in Banking/insurance, petroleum prospecting and mining industries. However since July 1995, the Federal Government of Nigeria promulgated the Nigerian Investment Promotion Commission decree (No 16) which essentially liberalise the Nigerian capital market. The decree provided the legal backing for the establishment of the Nigerian Investment Promotion Commission (NIPC), a body charged with the task of attracting foreign and domestic investment and creating friendly investment environment. The body repealed previous indigenisation legislation and allowed unrestricted foreign interest in quoted

companies; it also accords foreigners and residents the same rights, privileges and opportunities of investment, free reparation of capital, dividends, capital gains and other interests from investment in securities. The commission established over the counter (OTC) markets for the purchase of securities of unlisted companies; and authorised foreign investors to buy shares of Nigerian firms in any convertible currency. Moreover, foreign exchange (monitoring and Miscellaneous Provision) decree No 17 further enhances the determination of the government to improve the Nigeria capital market integration by removing barriers to capital inflow.

The foreign exchange (monitoring and miscellaneous provisions) decree 17 repealed Exchange Control Act of 1962; it established autonomous foreign exchange market; it allows free transaction in foreign exchange at market rates; and permits unrestricted import and export of foreign exchange. Effectively, barriers to international inflow were greatly reduced.

The 1986 – 1993 data shows that Nigeria has an average value of 0.64 and was ranked 20th out of 20 countries in terms of institutional development indicators. Zimbabwe had an average of 0.66 and was ranked 19th. Korea had 1.55 and ranked 3rd and turkey had 1.06 and was ranked 14th

From the study one can only conclude that as per the period covered, the institutional development and regulatory environment was far from expected. However, we hope that the recent reforms will improve the Nigerian capital market environment in terms of transparency, improved accounting standards and sovereign risk

The degree of error in asset pricing is an important indicator of stock market development. The law of equal price (Lop) holds when the same risk instruments are

price equally across international borders. The degree of pricing error is measured in relation to either International Arbitrage Pricing (IAPT) model or International Capital Asset Pricing model (ICAPM). The higher the values for IAPT or ICAPM, the greater the error in asset pricing and the less the integration of domestic market.

Pricing error is enhanced when there are barriers to capital flow; when capital market operations are not deregulated; and when there are no adequate information about firms in an economy.

In Nigeria, trading is by the call over system. Stocks are called up in turn and brokers bid for offer to sell any stock of interest. Unlike what obtains in most developed stock exchanges, trading time is restricted to about two (2) hours daily from Monday to Friday in NSE. Moreover, price movement ceiling was again reviewed from 10 Kobo to 20 Kobo in 1995. Since 1996, it was reviewed to accommodate 5% variation either way. The system of guided deregulation in security pricing implies that prices of shares on bid and those on offer are not completely market determined. A system of guided deregulation of stock pricing is meant to reduce excessive speculation thereby ensuring that prices are driven by fundamental. Other implications of non-freely floating stock prices according to Emenuyn (1996) share prices are not wholly sensitive to macro-economic variables as interest roles, money supply, and inflation. The pricing error estimates for the period 1986 – '98 computed using the IAPT and ICAPM for Nigeria are 3.66 and 3.72 respectively. In terms of ranking, Nigeria occupies 8^{th} and 11^{th} position out of 24 countries. Zimbabwe had IAPT and ICAPM pricing terms of 5.57 and 5.18 respectively for the same period. Zimbabwe ranks 18^{th} in both IAP and ICAPM, United States has the values of 2.71 and 2.24 with rank of 4^{th} and 3^{rd} respectively.

One can only conclude that the Nigeria capital market priced asset poorly for the indicated period when compared to USA and other industrial capital.

3.6 Transaction Costs and Settlement Process in the Nigerian Stock Market

Transaction cost in the Nigerian Stock market is considerable. These cost are both official and unofficial charges.

Brokerages are graduated from 2.75% downwards. In addition to stamp duty, NSEC charges 1% on every transaction in securities since 1985. NSE charges an additional fee of 1%. Emenuga (1998) reported that an equivalent transaction would cost 2% in Kenya and 2.35% in Zimbabwe. Stock ownership verification is a pre condition for the sale of securities in Nigeria and Brokers often make unofficial deductions for these services from the sellers' end. Buyers may face a mark up on stocks that are on high demand. Moreover, other risk in stock trading in Nigeria includes delay in remitting back monies for over subscribed stock to prospective investors. This sometimes takes up to six months before a refund is made.

In addition, Nigeria charges 20% capital gain tax on listed shares and 10% withholding tax on dividends. Malaysia 0% capital gain tax and 0% withholding tax on dividends. Korea (0%) capital gain tax and (16.5%) withholding tax on dividends. Indonesia (0%) capital gain tax and (0%) withholding tax on dividend. However, the Federal Government of Nigeria in 1998, abolished capital gain tax on stock and shares.

In the primary issues section of the market, the cost of IPO is also expensive. IPO application fee of 0.7% of the amount being raised is paid to NSEC; Issuing House fee is about 2.5% of proceeds; Brokers to the issue charge up to 0.5% of the

proceed; receiving banks and stock brokers to the tune of 1% of the proceeds. Underwriting fee is subject to negotiation and may be as high as 5%.

Amenuge (1998) observed that the official fees and brokerages alone for raising equity capital of US $1million in Nigeria amount to 2.5% (a brokerage of 1% and official fees totalling 1.5%. The composition of the charges for Ghana are 0.3% for fees and 2% brokerage. When the costs of administration, advertising and payments to professionals are added, the cost of raising U.S. $1 million equity capital in Nigeria bills up to about 4% of the value.

These costs are pecuniary, but there is the time cost. Delay in settlement of transaction is equally important because of the time value of money. Primary issue takes six months after the commencement of offer before approval is given for post offer trading. Moreover, investors have to wait to receive share certificate before trading could be done.

The rule for sales in the secondary market is T + 3. That is transactions should complete three days post deal. Investors often wait for a long time for share certificates. In the case of script issues, it takes more than three months between declaration and receipts of certificate after the annual general meeting.

The very slow pace of transacting in security is also noted when selling. The sellers must first liase with the Broker in order to have his share verified by the registrar. In between this time and the time the share finally gets to the buyer unwholesome trading may transpire to the detriment of the sellers.

However, stock trading in Nigeria has been centralised and computerised. The central securities cleaning system (CSCS) commenced operation in April 14, 1997. (The automatic trading system (ATS) has also become effective in all floors of the

exchange.) With the introduction of CSCS, share holders are now able to take advantage of share price appreciation since clearing period has been reduced to T + 5 after transaction. The objectives of CSCS are: real time transaction reporting; the use of automated order routing and execution systems; post trade comparison and analysis; and availability of audit trail data (Adeyemi 1998).

3.7 The Unorganised Securities Market

There is an unorganised securities market called over-the-counter (OTC), apart from the organised stock market expressed in a licensed stock exchange. OTCs, are markets for unlisted securities. In these markets, transaction in securities between buyers and sellers are conducted on their behalf by dealers and brokers by telex, telephones, computers or fax machines.

A dealer with a buy order for a particular security contacts a dealer with sell order for that security and both dealers bargain on the best deal possible for their clients until a bargain is struck. Unlike the organised stock exchange, securities prices in OTC are not easily known. This can be even more difficult in case of inactive securities. Securities' mispricing is the order in OTC.

3.8 Listing Requirement for the First -Tier Market

To be quoted in the NSE, every applicant must satisfy the following conditions:

1. Not less than 25% of the issued share capital, the said proportion having a minimum nominal value of N150, 000 must be made available to the public or be in the hands of the public.

2. The number of stockholders must not be less than 500 unless otherwise prescribed by council in individual cases.

3. The securities must be fully paid up at the time of allotment or registration.

4. Application for listing can only be entertained if sponsored by any of the dealing members of the original stock exchange.

A Company seeking listing must have at least five years of trading record and the date of the latest audited financial statement must not be more than nine months. A listed company on the first-tier is required to pay a quotation fee annually on its share capital.

The amount that a company can raise on the market is dependent on the financial absorptive capacity of the company. All companies quoted on the stock exchange are required to submit quarterly, semi-annual and annual statements of account to the stock exchange.

The listing requirements of the Nigerian stock exchange are aimed at achieving the following:

-Sustained high level of public confidence in the stock market

-Attainment of efficient securities market accessible to all investors.

- A reliable flow of information from quoted companies to the exchange to avoid any ambiguities, which could be exploited.

With these apparently stringent requirements for listing, companies still desire to be quoted on the exchange because:

--Listing lends prestige to, and widens the market for a company's securities.

--The company with such a reputation could therefore raise funds more easily and cheaply than new issues since investors will have built confidence in them by virtue of their being listed.

--Investors tend to build up confidence in stock that have been listed since such stock can easily be disposed of and the price determined.

--Shares listed on the exchange are usually more liquid and easily marketed.

--The greater marketability of stocks makes them more acceptable to financial institution as collateral for loans.

--The investor has abundant information about the price of his securities.

--Quoted firms benefit from the free publicity arising from reported trading activities on the exchange, especially if its stocks are actively traded.

3.9 The Second Tier- Securities Market

The second-tier securities market (SSM) was created in April 1985 to cater for firms that could not otherwise qualify for listing on the first-tier market. The SSM operate in much the same manner as the first-tier market except that it is less regulated in terms of listing requirements. The SSM is also in the official list of the exchange.

Listing Requirement of SSM

The following conditions must be satisfied before being listed in the (SSM):

i. It must be registered as a public limited company.

ii. At least 10% or 50,000 of the equity of the company must be in the hands of the public except in the case of an offer for introduction.

iii. No shareholder can own more than 75% of the issued share capital of the company.

iv. It must submit the financial statements for the last three years in business prior to quotation to the Nigeria Stock Exchange. Thereafter, audited half-yearly and annual statement must be submitted to the stock exchange.

3.11 Methods of Marketing Securities (The New Issues Market)

New issue market is also known as the primary market. It is the market for newly issued securities. Secondary market is a market for second hand securities in the stock exchange. The following constitute the methods for marketing new securities in the capital market:

i. **Offer for Subscription**

This is also called issue by prospectus and it involves a direct sale or issue of stocks and share by a firm to the general public. The proceeds of the issue go to the issuing company directly.

ii. **Offer for Sale**

This is a public offer of stocks and shares in a firm by existing stockholders. The money realised from the sale goes to the sellers or vendors. An offer for sale can also be by tender, in which case the vendors or sellers would quote a minimum selling price for the stock below which they would not sell.

iii. **Stock Exchange Introduction**

If a firm already has enough of its shares (the minimum 25% required to go public) in the hands of the investing public and wants to seek listing on the stock exchange, the NSE can grant it permission to introduce its securities and have them quoted on the exchange. This is introduction and no new stocks are really issued by this method.

iv. **Private Placement (Also Called Placing)**

An unquoted firm may wish to sell its stocks to a selected group of investors rather than directly to the investing public. This is private placement. It is the Issuing House or stockbrokers that undertake to sell the stocks to its clients on behalf of the company. It saves both time and floatation costs. However, private placements are rarely allowed in the Nigerian stock exchange.

v. **Right Issues**

These are issues of new share by a firm to its existing shareholders rather than the general public. The offer price is often lower than the value of the others. It is an incentive to shareholders to retain their corporate loyalty.

CHAPTER FOUR

MODEL SPECIFICATION AND DISCUSSION

4.0 Introduction

We examine the ex-ante and ex-port characteristics of IPOs. Cross sectional character and trends of variables that motivate or deter IPOs are the focus here. We analyse performanace and other features of quoted firms-pre and post IPOs. Our period of analysis is for t=+3, +2, +1 and t= -1, -2, -3. We also did the post Hoc, mean comparison tests using Turkey's test and Scheffe test to identify sources of differences if any. Results obtained either refute or validate claims for IPOs in Nigeria

4.1 Model Specification

The model is specified thus:

$$E(y)=\beta_0+\sum_{j=1}^{3} B_j IPO_j+\varepsilon_i$$

IPOj = a dummy (or indicator) variable for level i

$$IPO_j = \begin{cases} 1 & \text{if } y \text{ is observed as } j=i \\ 0 & \text{if otherwise i.e } j\neq i \end{cases}$$

E(y) = mean response

β_0 = mean value of y at IPO year

B_j = mean value of y at period j = +1, +2 +3 post IPO and j = -3, -2 , -1 pre IPO

ε_i = error term

Variable on financial structure and operating performance are obtained from the balance sheet operating statement and fund flow statements of selected quoted firms. Sources of information include prospectuses, annual reports and the Nigerian Stock Exchange Facts Book. The model monitors firms performance and other characteristics affecting the probability of IPOs. The coefficients are tested using F-statistics at alpha level of 0.05 to determine if there are significant variations pre and post IPOs.

4.2 Discussion

The variables examined are:

a) Gearing (G_0) = a ratio of a firms long-term debt capital (D_0) to equity capital (E):

ie D_0/E_0

Gearing determines the cost of investment and profitability of a firm. It is a reflection of financial leverage risk, control over earnings of a firm and the structure of corporate governance.

D_0 = debentures and loan stock + preference stock. They are long-term liabilities with fixed annual return (contractual interest changes and fixed preference stock dividends) Holders of fixed return debt stock are creditors not owners as it is the case of ordinary issues.

E_1 = Ordinary share capital + reserves. Reserves include both statutory and non statutory - share premium, revaluation, general and retained earnings.

Equity capital are ownership capital. Dividend payment to common

stakeholders are not obligatory charges but are based on a firms performance and declaration by the board of directors. Gearing indicates the level of risk exposure. A highly geared firm faces the risk of insolvency and bankruptcy because obligations are contracted. However, gearing benefits in periods of inflation and growth in income because shareholders returns are maximised. It may also be preferred as a means of maintaining control. One other attribute of a highly geared firms is that extra capital becomes expensive and scarce because of the level of the high financial leverage risk. Incentive to renege on promise becomes very high. D_0/E_i ratio is expected to be high and increaing in value pre IPO and decreasing post IPO, ex-ante.

b. Financial leverage (FL) = the amount of asset held in relation to stock-holders equity and amount financed with borrower funds. FL ratio also reflects the cost of capital, risk and control.

$$FL = \frac{\text{Net Asset}}{\text{Equity}}$$

Net Asset = Ordinary share capital + preference stock + reserves + debentures stock.

Equity = Ordinary share capital + reserves.

c. Interest cover (IC) = the ease with which annual interest payment can be made.

It is a ratio of profit available for the payment of interest to fixed annual interest.

$$IC = \frac{\text{Earning before interest, tax}}{\text{fixed, interest}}$$

IC is important because debentures and loan stock are long-term liabilities

they attract contractually fixed annual interest charges. Owners of loan stock can take legal action to secure their interest; and it may lead to bankruptcy and liquidation. Preference shares are similar to fixed rate capital because they receive fixed dividends.

A ratio of five (5) is believed to be an acceptable cover. We expect a decreasing value for IC pre IPO and an increasing value for IC post IPO.

d. Dividend Cover (DC) = the amount by which earnings can fall before dividends at present level cannot be paid. Cost of loan stock affects dividend payments to ordinary share-holders. The ordinary share holder benefits from gearing when profits are rising but gearing adversely affects him during losses.

$$DC = \frac{\text{Earnings after interest, tax, preference dividend}}{\text{Ordinary dividend}}$$

A ratio of two (2) is widely accepted as a reasonable cover. Acceptable DC is much lower than IC because dividends are not contractual charges. DC also indicates dividend and retention policy. Therefore DC affects the likelihood of IPO since high DC means internal source of funds for investment and less of earnings of firms for outsiders. Therefore outside control over resource and management is reduced. We therefore expect a falling DC pre IPO and increasing DC post IPO.

e. Dividend pay-out ratio (PO) = the amount of dividend per share divide by earnings per share. PO ratio affects earning reinvested.

$$PO = \frac{\text{Dividends per share (Ordinary)}}{\text{Earnings per share}}$$

The greater the PO ratio, the less the amount available for reinvestment. A firm with large investment outlay will likely reduce its pay out ratio. What a firm does with P/O ratio signifies its need or lack of need for external funds. Going public because of a need for funds to meet a firms market growth prospects and hence investment outlay will imply that a firm's pay out ratio will face a downward trend post IPO.

The value of a business as a going concern does not depend on the assets it owns; it depends on how efficiently assets are used as measured by profit records. Profitability of a firm is measured in relation to resources employed. Profitability and efficiency in the use of a firm's resources are captured using

f. Operating leverage (ATO) = a ratio of sales to net assets of a firm. It indicates the amount of sales revenue generated by each naira worth of asset.

$$ATO = \frac{Sales}{net\ Asset}$$

Net Asset= fixed asset + working capital. working capital = current asset - current liability.

Net Asset is also generated as capital employed = shareholders funds. + debentures/Loan stock. Shareholders funds = ordinary share capital + preference shares + reserves. ATO is used as a proxy for the need for funds since sales and profitability indicate growth. We expect an increasing value for ATO pre and post IPO.

g. Return on asset (ROA)

$$= \frac{\text{EBIT}}{\text{Long-term capital employed}} \quad \text{or} \quad = \frac{\text{EBIT}}{\text{Net Asset}}$$

EBIT = Net profit + interest + tax

long-term capital share = capital + reserves + loan stock

Net Asset = Fixed asset + working capital.

ROA is a profitability and efficiency measure.

h. Operating Margin (ROS) = the amount earned in Net profit for each naira worth of sales.

$$\text{ROS} = \frac{\text{Net Profit}}{\text{Sales}} \times 100$$

high operating expenses in a firm will cause a fall in operating margin.

i. Gross profit margin (GPM) = the ratio of gross profit to sales expressed as a percentage

$$\text{GPM} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

j. Earnings per share (EPS) = earnings attributable to one ordinary share expressed in Kobo. It is the earning power of one ordinary share; the contribution of one ordinary to earnings of a firm. EPS corresponds to the maximum dividend that can be declared. A negative EPS indicates dividends from reserves because of negative earnings in current year. Shareholders expect an increasing EPS.

$$\text{EPS} = \frac{\text{Earning after interest, tax and preference dividend}}{\text{No of ordinary shares}}$$

EPS can increase for two reasons

i. Because of increased performance in the use of assets.

ii. Because of increased use of asset financed through retained earnings.

k. Price- earning multiple (PEM) ratio of current market price of ordinary share to its eanring power (EPS). It measures the number of years earnings an investor is willing to pay to acquire ownership right represented by one ordinary share

$$\text{P-Emultiple} = \frac{\text{Market Price (net)}}{\text{EPS}}$$

A low P-Emultiple is an indication of under - valuation of stock of a firm while a high P-Emultiple indicates an over valued firm. P-Emultiple depends on market expectation of a firm growth potential and its ability to maintain or increase earnings P-E multiple may also be used to set the price of new issue; with a rising P-Emultiple, cost of capital falls. Principally P-E multiple indicate the number of times market price of an ordinary share exceeds its earning power.

l. Dividend Yield (DY)= a ratio of dividend to market capitalisation of ordinary share expressed in percentage; it is an expression of dividend return on current market price. Return is before personal tax

$$\text{DY} = \frac{\text{Dividend per share}}{\text{Market price per share}} \times 100$$

m. Earning Yield = A reciprocal of P-E multiple

$$\text{EY} = \frac{\text{Earnings}}{\text{market price}} \times 100$$

EY is an expression of earnings on current market price. It is a rate of return. Shareholders expect a growing earning yield. It is an indication of profitability of investment.

n. Share holders fund (SHF) = Share capital (ordinary) + preference shares +

reserves

a growth in SHF is an indication of improved well being of the firm and wealth of owners of the firm.

CHAPTER FIVE

5.0 Data Analysis

We examine data on operating performance of IPO firms in Nigeria. The behaviour of important financial variables relating to financial structure of quoted firms pre and post IPOs are also observed. We present the analysis below. Firms are observed before and after IPOs separately and then synthesised under discussion. We also analysed opinions of business executives in selected private firms.

TABLE 1. GEARING FOR SELECTED QUOTED FIRMS PRE IPO IN %

Firms	-3	-2	-1	IPO YEAR
001	38.6	20.6	13.6	08.1
002	51.1	039.0	66.6	72.5
003	32.4	032.4	9.9	18.4
004	355.0	353.4	260.4	207.1
005	79.3	185.5	217.7	52.2
006	04.9	07.9	02.4	024.4
007	373.1	581.0	255.8	327.1
008	00.0	00.0	00.0	00.3
009	247.9	429.2	420.5	654.5
010	00.0	00.0	00.0	00.3
011	02.6	60.6	132.2	04.3
012	161.1	084.8	154.9	155.6
013	00.0	00.0	00.0	00.0
014	44.7	29.0	18.2	86.6
TOTAL	1390.7	1895.4	1552.5	1589.4
AVERAGE	99.3	135.4	110.9	113.5
$\alpha = 0.05$ $df_1 = 3$ $df_2 = 52$ F = 0.1228333 F(Crit) = 2.782599 P = 0.946227				

Source: Appendices A1.1 and A1.2 (Computed). Gearing = fixed long -term debt/equity.

Gearing stood at high level pre IPO. Gearing increased from an average value of 99.3% three years pre IPO to 135.4% two years pre IPO. It again dropped to 110.9% a year pre IPO. Gearing pre IPO is above 100 % and the trend generally is

upward though the difference is not statistically significant. High gearing implies high financial risk; substantial part of the income goes into servicing debts; shareholders dissatisfaction; risk of bankruptcy and possible liquidation. Most importantly, highly geared firms have incentive to renege on promises and so not likely to obtain enough funds for its projects.

TABLE 2. FINANCIAL LEVERAGE FOR SELECTED FIRMS PRE IPO (IN%)

FIRMS	-3	-2	-1	IPO YEAR
001	138.7	159.7	152.0	152.2
002	151.1	139.1	166.6	122.5
003	155.8	255.0	189.4	210.8
004	100.0	100.0	100.0	100.0
005	768.9	884.6	165.9	500.4
006	105.0	107.9	102.4	102.3
007	103.1	124.6	685.8	778.5
008	100.0	100.0	100.0	100.3
009	100.0	100.0	100.0	100.0
010	100.0	100.0	100.0	100.0
011	102.0	160.6	232.2	14.3
012	261.1	184.8	154.9	155.6
013	100.0	100.0	100.0	100.0
014	156.2	138.8	633.7	118.9
TOTAL	2441.9	2625.1	2982.9	2655.6
AVERAGE	174.4	187.5	213.2	189.7
α =0.01 $df_1 = 3$ $df_2 = 52$ F=0.0954362 F(Crit) = 2.182599 P = 0.962224				

Source: Appendices A1.3 and A2.2 computed FL = Net Asset/Equity

Financial leverage increased for the three years pre IPO from 174.4% to 187.5% and 213.2%. The trend is upward though average growth is not statistically significant. The increasing trend indicates growing net asset relative to equity holding in the firms. High financial leverage indicates high debt financing relative to equity. High leverage indicates high financial and operating risks and possibility of bankruptcy. It also implies that much of business gains accrue to outsiders. It also implies that funding will be adequate due to high risk of default.

TABLE 3. OPERATING MARGIN PRE IPO IN %.

FRIMS	-3	-2	-1	IPO YEAR
001	004.0	003.5	009.2	005.1
002	009.2	016.7	053.8	021.0
003	004.9	000.8	000.9	02.5
004	250.7	010.9	020.5	017.6
005	026.5	018.3	024.2	010.4
006	008.1	008.8	009.6	008.9
007	041.2	042.3	040.2	033.0
008	012.7	007.4	009.6	005.1
009	027.6	027.6	028.6	030.9
010	004.6	095.4	009.4	008.6
011	006.4	013.6	003.5	002.4
012	002.5	007.5	079.8	008.8
013	193.7	331.8	485.4	112.8
014	009.6	010.6	010.7	009.6
TOTAL	601.7	595.2	785.4	275.0
AVERAGE	43.0	42.5	56.1	19.8
α=0.05 df_1=3 df_2=52 F=0.424007 F (Crit)=2.782599 P=0.736585				

Source: Computed from Appendices A1.5 and A1.4

Operating Margin = Earnings after tax/Turnover

Operating margin dropped slightly from an average value of 43.0% three years pre IPO to 42.5% two years pre IPO. It again increased by 13.6 percentage point to 56.1% pre IPO. The upward trend, though, is not statistically significant. Upward trend in operating margin implies increased profitability of firms seeking IPO. Increasing operating margin may also be taken to explain increased need for funds for expansion and modernisation.

TABLE 4: OPERATING LEVERAGE FOR SELECTED QUOTED FIRMS PRE IPO (IN%)

FIRMS	-3	-2	-1	IPO
001	417.8	490.3	402.0	395.0
002	063.9	100.3	300.2	86.5
003	17.9	02.1	16.0	23.5
004	169.9	00.0	181.9	201.1
005	32.5	02.4	21.8	37.1
006	379.9	435.7	199.2	84.4
007	12.7	104.6	175.6	111.0
008	442.6	440.1	371.8	484.7
009	233.6	231.6	203.5	196.9
010	206.7	14.9	151.6	225.2
011	140.1	102.9	99.0	71.2
012	051.3	034.3	080.2	163.6
013	002.2	00.1	00.0	00.2
014	165.8	237.6	239.2	291.8
TOTAL	2339.91	2196.9	244.2	2372.2
AVERAGE	167.1	156.9	174.0	169.0
α=0.05 df_1=3 df_2=52 F=0.03219 F (Crit)=2.782599 P=0.99188				

Source: Computed from Appendices A1.4 and A1.3

Operating leverage = Turnover/Net Asset

Average operating leverage pre IPO decreased from 167.1% to 156.9% two years before IPO. A year pre IPO saw an increase to an average value of 174%. Because of the high value for operating leverage, one may argue that these firms are not low quality firms. Divestment with the aim of reinvesting in more profitable venture may not necessarily be a strong motive for IPO.

TABLE E 5: RETURN ON ASSET PRE IPO IN PERCENTAGE

FIRMS	-3	-2	-1	IPO
001	01.9	17.6	20.7	20.1
002	05.9	16.1	16.1	14.1
003	00.9	00.1	00.1	00.6
004	49.0	23.6	37.3	35.3
005	08.6	04.4	05.3	03.9
006	31.0	38.3	19.2	06.9
007	56.2	32.4	35.7	19.7
008	64.4	64.0	58.3	60.8
009	09.7	20.3	14.2	18.0
010	09.3	16.5	03.4	01.7
011	01.3	02.6	06.4	14.4
012	04.2	05.9	01.2	02.2
013	16.0	25.2	26.2	28.1
014	05.2	04.4	07.1	03.8
TOTAL	263.6	272.0	251.2	229.6
AVERAGE	18.8	19.4	17.9	16.4
α =0.01 $df_1 = 3$ $df_2 = 52$ F=0.0710754 P=0.975162 F(Cirt)=2.782599				

Source: Appendices A1.5 and A1.3 computed

ROA = Profit after tax/net assets

Return on assets (ROA) increased from 18.8% to 19.4%. The value then falls by 1.5 point to 17.9% pre IPO. It further declined to 16.4% in the year of IPO. These values show a progressive decline in profitability and efficiency of firms seeking IPO. This may give vent to the perception of firms seeking IPO as low quality firms whose profits are about to decline permanently. Declining profitability may have resulted form high operating cost relative to fixed cost.

TABLE 6: GEARING FOR SELECTED QUOTED FIRMS POST IPO (IN%)

FIRMS	IPO YEAR	-1	-2	-3
001	125.2	59.5	127.0	79.9
002	35.7	23.8	22.2	10.6
003	19.8	38.9	32.8	17.1
004	374.2	132.9	62.9	68.6
005	0.0	00.0	0.0	0.0
006	147.6	139.0	121.0	116.9
007	00.0	00.0	14.9	10.6
008	62.6	60.6	59.0	40.7
009	299.5	195.2	210.3	188.4
010	61.0	55.5	54.0	43.2
011	40.0	19.0	34.1	14.8
012	00.0	00.0	00.0	00.0
013	00.0	00.0	00.0	00.0
014	22.1	00.0	00.0	00.0
TOTAL	1187.7	724.4	738.2	612.6
AVERAGE	84.8	51.7	52.7	42.2
A=0.05 df1=3 df2=52 F=0.093206 F(Cirt)=2.782599 P=0.793296				

Source: Computed from Appendices A2.1 and A2.2

Gearing = Debt Capital/Equity

The financial structure changed dramatically a year after IPO. Gearing dropped from high value of 84.8% to 51.7%, a year after IPO. This represents 33.1% point drops on the average. The figure increased slightly to 52.7% in the second year of IPO and again dropped sharply to 43.8%. The trend clearly is downward. This conforms to our expectation that IPO was effected to change the financial structure of the firms with firms preferring less debt exposure. This is expected to reduce high leverage and risk of bankruptcy.

TABLE 7: FINANCIAL LEVERAGE POST IPO (IN%)

FIRMS	IPO	+1	+2	+3
001	1585.0	1322	1605.0	1099.0
002	135.7	123.7	114.4	110.5
003	119.8	154.2	123.0	116.3
004	531.2	297	175.7	165.8
005	100.0	100.0	100.0	100.0
006	1575.9	1691.8	1716.8	816.9
007	246.6	296.5	223.8	123.7
008	215.1	218.9	229.9	217.9
009	133.7	378.2	376.0	308.9
010	161.0	155.5	158.0	143.2
011	140.3	199.1	144.1	300.8
012	100.0	100.0	100.0	100.0
013	100.0	100.0	100.0	100.0
014	100.0	100.0	100.0	100.0
TOTAL	5244.3	5158.3	5066.0	3877.0
AVERAGE	374.6	374.1	376.2	371.6
α =0.01 $df_1 = 3$ $df_2 = 52$ F=0.163917 F(Crit)=2.782599 P=0.920185				

Source: Computed from Appendices A2.3 and A2.2

F/L = Net Asset/Equity

Financial leverage (F/L) is net asset relative to equity capital. Financial leverage ratio show a downward trend from 374.6% in IPO year to 374.1% a year after IPO. It increases by 2.1 percentage point second year after IPO. The third year again saw a decline to 371.6% however, the rise and fall in value of financial leverage is not statistically significant at α= 0.05

TABLE 8: OPERATING LEVERAGE POST IPO (IN%)

FIRMS	IPO YEAR	+1	+2	+3
001	16.3	15.0	16.7	13.6
002	151.8	133.1	114.5	162.2
003	121.7	112.2	148.7	141.5
004	67.9	68.5	119.5	182.0
005	173.8	208.2	227.7	139.3
006	47.1	52.2	53.8	53.5
007	99.5	126.6	85.6	79.6
008	160.0	168.2	167.2	157.2
009	105.8	34.6	36.7	44.3
010	79.4	61.6	81.1	73.5
011	36.2	40.7	64.0	38.3
012	96.0	100.6	133.3	184.6
013	145.5	211.6	103.9	155.3
014	113.2	150.1	192.2	227.0
TOTAL	14142	1483.2	15449	16519
AVERAGE	101.0	105.9	110.4	118.0
α =0.01 $df_1 = 3$ $df_2 = 52$ F=0.203328 F=(Crit)=2.782599 P=0.893631				

Source: Computed from Appendices A2.4 and A2.3

Operating leverage = Turnover/Net asset

Operating leverage rose to 105.9% and 110.4% in the first two years after IPO. It further increased to 118% three years post IPO . Operating leverage in the three years is much higher than the average value in IPO year. It implies greater efficiency in the use of firms capacity in generating sales. This may have resulted from greater economy of scale consequent upon public offer of shares.

TABLE 9: RETURN ON ASSET POST IPO (IN%)

FIRMS	IPO YEAR	+1	+2	+3
001	3.8	1.0	2.9	2.2
002	43.1	41.3	36.5	49.6
003	25.2	30.6	31.7	26.3
004	03.3	05.3	10.0	25.7
005	65.5	57.2	66.3	34.5
006	03.6	0.7	02.6	0.3
007	13.1	8.3	04.8	04.6
008	35.2	23.4	33.5	38.5
009	41.4	17.0	15.0	91.2
010	4.9	19.8	26.5	01.6
011	2.0	04.4	6.2	01.8
012	16.4	23.0	34.0	56.6
013	04.7	06.8	07.6	26.6
014	11.2	18.0	20.6	33.9
TOTAL	373.4	256.8	298.2	393.4
AVERAGE	19.5	18.3	21.3	28.1
α =0.01 $df_1 = 3$ $df_2 = 52$ F=0.641356 F(Crit)=2.782599 P=0.591869				

Source: Computed from Appendices A2.5 and A2

ROA = Profit after tax/Net asset

Return on asset declined by 1.2 percentage point a year IPO. Here after, we observed an upward trend of 21.3% and 28.1%. The increase in ROA post IPO may be attributed to improved use of resources in generating earnings. The observed increase in ROA post IPO is however not statistically significant .

TABLE E 10: OPERATING MARGIN POST IPO (IN%)

FIRMS	IPO YEAR	+1	+2	+3
001	23.4	07.0	17.4	16.4
002	28.5	31.1	31.9	30.6
003	20.7	27.2	21.3	18.6
004	04.8	07.7	08.4	14.7
005	37.0	27.5	29.1	24.8
006	07.6	01.4	04.9	06.7
007	14.6	07.0	05.7	05.7
008	22.0	14.6	20.1	24.5
009	39.1	49.0	40.9	20.6
010	44.0	32.0	32.6	22.1
011	05.7	10.8	09.7	04.7
012	17.2	22.8	24.4	30.8
013	03.2	07.6	07.3	16.5
014	10.4	12.7	10.7	15.0
TOTAL	278.2	258.4	264.4	251.2
AVERAGE	19.9	18.5	18.9	17.9
α =0.01 $df_1 = 3$ $df_2 = 52$ F-0.64455 F(Crit)=2.782599 P=0.978417				

Source: Computed from Appendices A2.5 and A2.47

Operating margin = Profit after tax/sales

Earnings after tax and sales (net) increased in absolute terms post IPO. However, operating margin tends to have a downward trend post IPO though this difference tends to be insignificant . The relatively higher average operating margin in the IPO year may be due to the observed window dressing of accounts of firms seeking quotation at the stock exchange. This often explains why SEC adjusted financial statement of firms offering shares to the public. The argument is that operating margin (ROS) which are at high levels of 18.5% 18.9%, 17.9% post IPO are high level operating performance consequent upon IPO.

TABLE 11: EARNINGS PER SHARE POST IPO (IN KOBO)

FIRMS	IPO YEAR	+1	+2	+3
001	06.00	4.00	10.00	12.00
002	73.80	66.90	121.10	85.60
003	25.96	40.06	46.42	41.99
004	05.80	07.40	10.49	29.90
005	18.10	22.00	33.60	36.00
006	13.15	04.23	16.95	35.57
007	09.11	10.05	10.21	08.61
008	20.00	19.00	40.00	13.00
009	43.70	48.60	60.00	47.43
TOTAL	215.62	222.7	348.8	369.4
AVERAGE	43.12	44.45	68.75	62.02
α =0.01 $df_1 = 3$ $df_2 = 32$ F=0.67956 F(Crit)=2.901118 P=0.67956				

Source: Company Annual Report (various issues)

EPS = Profit after tax/no of ordinary shares

Earning per share post IPO increased from 43K to 44.5K in the first year post IPO. It grew to 68.8k and 62k two and three years post IPO. Earning power of a share grew over the three years. Growing EPS indicate growing shareholders satisfaction because of growth in investment return.

TABLE 12: DIVIDEND PER SHARES (IN KOBO)

FIRMS	IPO YEAR	+1	+2	+3
001	03.00	-	6.00	7.00
002	22.00	26.00	27.00	50.00
003	06.40	12.50	14.00	15.00
004	05.00	09.00	10.00	15.00
005	17.00	08.90	16.70	25.00
006	07.50	-	08.00	12.50
007	06.67	06.67	07.00	06.00
008	05.00	05.00	15.00	15.00
009	17.50	25.00	25.00	20.00
TOTAL	90.07	93.07	128.70	165.50
AVERAGE	10.01	13.30	14.30	18.39
α =0.01 $df_1 = 3$ $df_2 = 32$ F=0.67956 F(Crit)=2.901118 P=0.328733				

Source: Company Annual Report (various issues)

DPS = Dividend/No of ordinary shares

The three years post IPO experienced growth in dividend per share (Fig G2). The average dividend per share rose from 10.01k IPO year to 13.30k, 14.30, 18.39 Kobo three years post IPO. The trend is sharply upward though slightly insignificant.

TABLE 13: PAYOUT RATIO (IN %)

FIRMS	IPO YEAR	+1	+2	+3
001	50.00	00	60	58
002	30	40	22	58
003	24	31	30	36
004	86	127	95	50
005	93	41	50	69
006	57	00	47	35
007	73	118	69	69
008	25	26	38	21
009	40	51	42	42
TOTAL	479	433	430	428
AVERAGE	53.1	48.2	47.8	45
α =0.01 $df_1 = 3$ $df_2 = 52$ F(Crit)=2.901118 P=0.984863				

Source: Table F2 and G2

P/O = Dividend per share/Earning per share

This is a steady decline in payout ratio from 53% to 48%, 47% and 45% Declining payout ratio indicates higher level of retain earnings for internal financing and less reliance on external creditors.

TABLE 14: DIVIDEND COVER (Times)

FIRMS	IPO	+1	+2	+3
001	1.8	-	1.7	1.7
002	2.9	3.3	4.8	3.4
003	3.2	3.2	3.3	-
004	1.2	1.1	1.1	2.0
005	2.0	2.5	2.0	1.5
006	1.8	-	2.1	2.8
007	1.4	1.5	1.5	1.4
008	3.9	3.9	2.7	4.8
009	2.7	2.4	1.9	2.2
	4.6	3.8	3.6	-
TOTAL	25.5	21.7	24.7	19.8
AVERAGE	2.5	2.2	2.5	2.0
α =0.01 $df_1 = 3$ $df_2 = 32$ F=0.086472 F(Crit)=2.901118 P=0.966946				

Source: Annual Report of quoted firms (Various issues)

$$DC = \frac{\text{Profit after tax minus preference dividend}}{\text{Ordinary dividends}}$$

The dividend cover three years post IPO is either 2 or above. The values are acceptable cover by norm. It indicates that on the average firms are able to bear cost of capital to ordinary shareholders. They are therefore able to sustain share market value. There is a stable dividend policy.

Business Executive Opinion Survey

1. Does IPO underpricing deters your firm from going public?

Table 15

Response	SA	A	U	D	SA
No	3	4	2	2	1
%	25	33	17	17	8

Out of the 12 chief executives interviewed in Nigeria, 33% agreed that IPO underpricing is deterrence to going public

25% strongly agreed

17% were undecided

17% disagreed

8% strongly disagreed

2. Do not want to disclose

Table 16

Response	SA	A	U	D	SA
No	2	1	1	5	3
Percentage %	17	8	8	42	25

42% of the chief executives of the unquoted firms disagreed that the need to disclose is a deterrence to going public in Nigeria.

25% strongly disagreed

17% strongly agreed

8% agreed and

8% were undecided

3. Do not want to lose control

Table 17

Response	SA	A	U	D	SA
No.	5	3	1	2	1
Percentage %	42	25	8	17	8

45% strongly agreed that they remain private because of the fear of losing control

25% agreed

17% disagreed

8% strongly disagreed

8% were undecided

4. Have high credit rating

Table 18

Response	SA	A	U	D	SA
No	1	2	4	3	2
Percentage %	8	17	33	25	17

33% of the chief executives interviews were undecided on the issue of credit rating

25% disagreed that they have high credit rating

17% strongly disagreed

17% agreed

8% strongly agreed

5. Have no need for external fund.

Table 19

Response	SA	A	U	D	SA
No	0	0	1	5	6
Percentage %	0	0	8	42	50

50% of the chief executives interview strongly disagreed that they do not have need for external funds.

42% disagreed

8% were undecided

0% agreed

0% strongly agreed

6. Little tax advantage

Table 20

Response	SA	A	U	D	SA
No	0	5	4	2	1
Percentage %	0	42	33	17	8

42% agreed that there is little tax advantage in when listed.

33% were undecided

17% disagreed

8% strongly disagreed

7. Low Bank charges

Table 21

Response	SA	A	U	D	SA
No	0	0	2	4	6
Percentage %	0	0	17	33	50

50% strongly disagreed that bank charges are low

33% disagreed

17% were undecided

0% agreed

0% strongly agreed

KASHIM IBRAHIM LIB

8. High Issuance cost

Table 22

Response	SA	A	U	D	SA
No	4	7	1	0	0
Percentage %	33	58	8	0	0

58% agreed that issuance cost for IPO is high

33% strongly agreed

8% were undecided

0% disagreed

0% strongly disagreed

9. Reduce visibility

Table 23

Response	SA	A	U	D	SA
No	1	2	4	3	2
Percentage %	8	17	33	25	17

33% were undecided on whether the need to stay private is motivated by a need to avoid visibility to tax authority

25% disagreed

17% strongly disagreed

8% strongly agreed

FIG 1a: GEARING FOR SELECTED QUOTED FIRMS PRE IPO IN PERCENTAGE

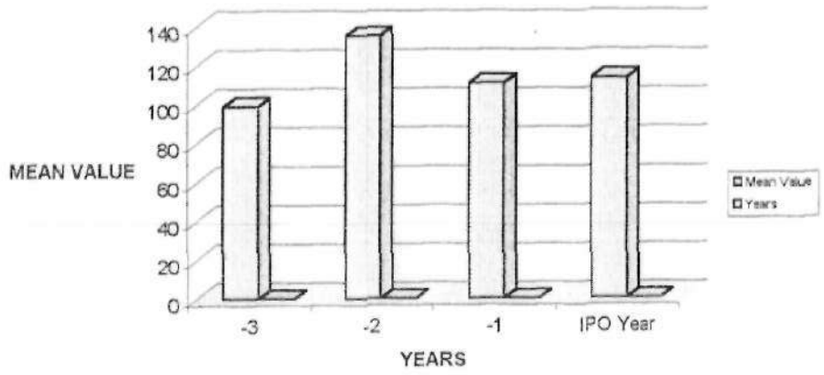


FIG 1b: GEARING FOR SELECTED QUOTED FIRMS PRE IPO IN PERCENTAGE

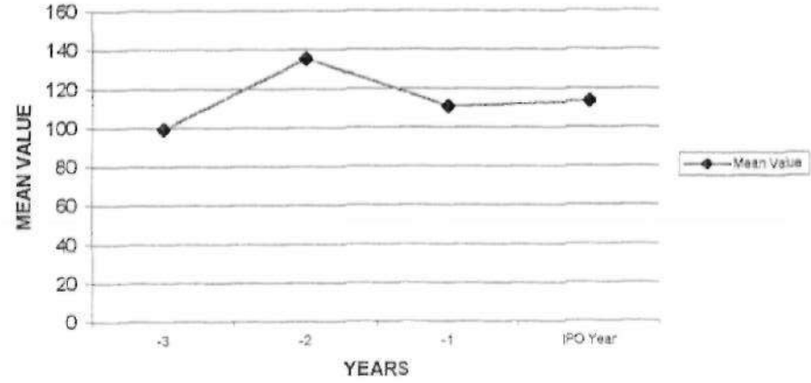


FIG 2a: FINANCIAL LEVERAGE FOR SELECTED QUOTED FIRMS PRE IPO IN PERCENTAGE

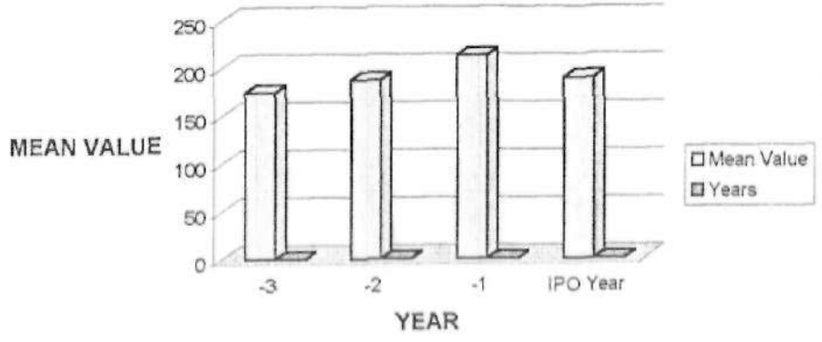


FIG 2b: FINANCIAL LEVERAGE FOR SELECTED QUOTED FIRMS PRE IPO IN PERCENTAGE

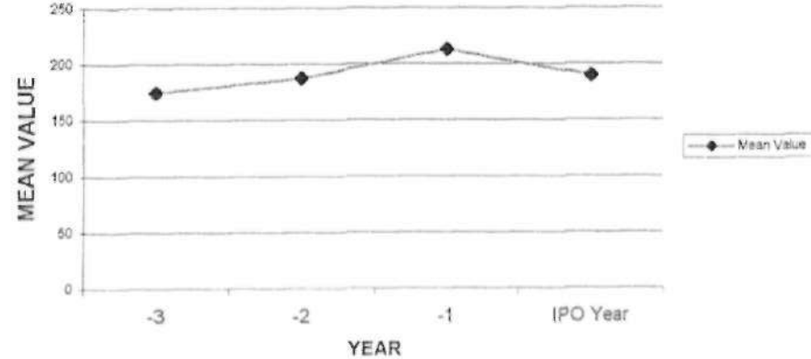


FIG 3a: OPERATING MARGIN OF SELECTED QUOTED FIRM PRE IPO IN PERCENTAGE

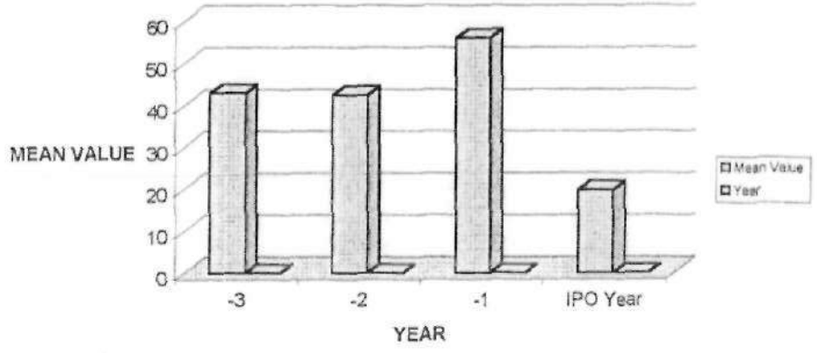


FIG 3b: OPERATING MARGIN FOR SELECTED QUOTED FIRMS PRE IPO IN PERCENTAGE

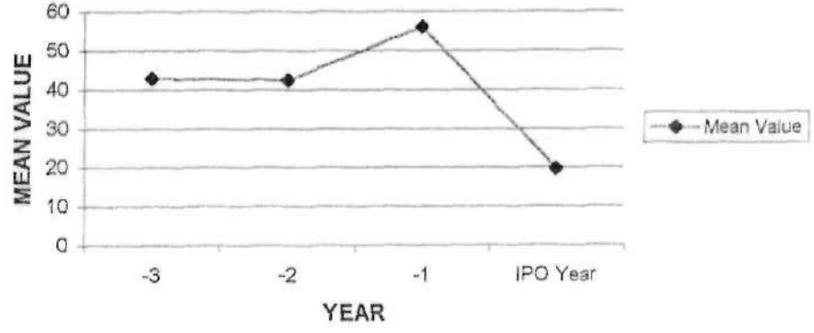


FIG 4a: OPERATING LEVERAGE FOR SELECTED QUOTED FIRMS PRE IPO IN PERCENTAGE

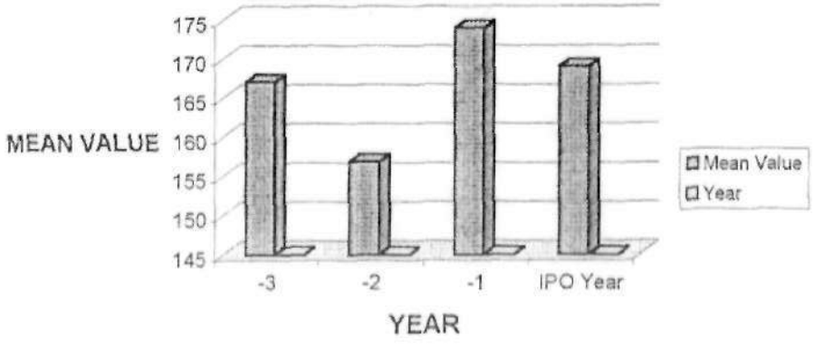


FIG 4b: OPERATING LEVERAGE FOR SELECTED QUOTED FIRM PRE IPO IN PERCENTAGE

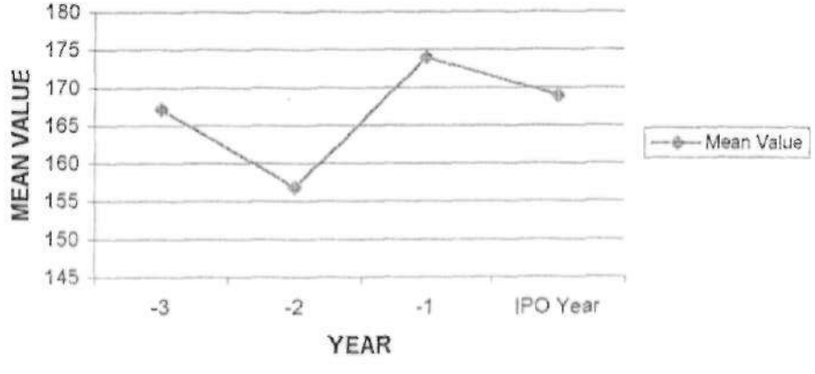


FIG 5a: RETURN ON ASSETS PRE IPO IN PERCENTAGE

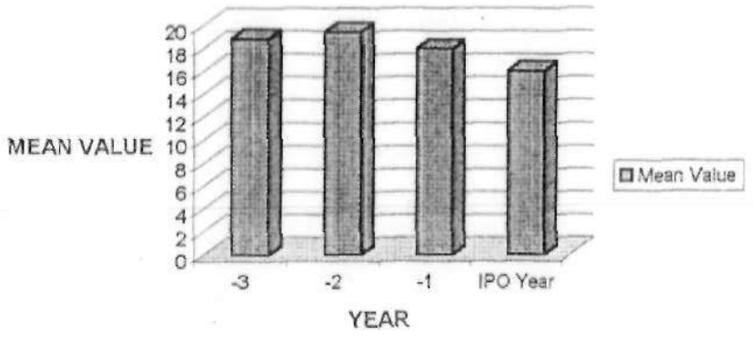


FIG. 5b: RETURN ASSETS PRE IPO IN PERCENTAGE

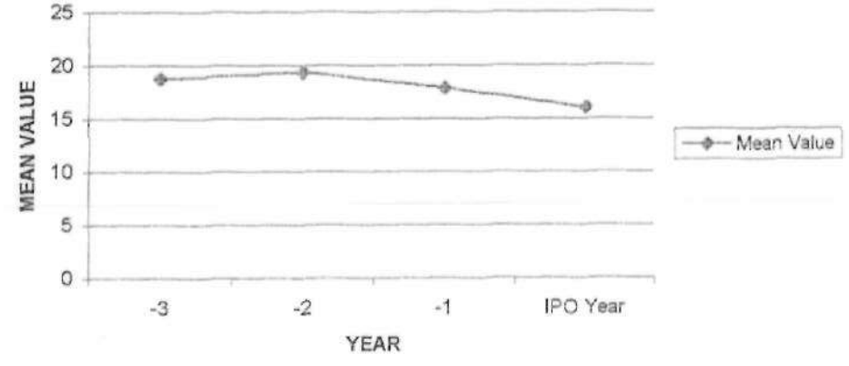


FIG 6a: GEARING FOR SELECTED QUOTED FIRMS POST IPO

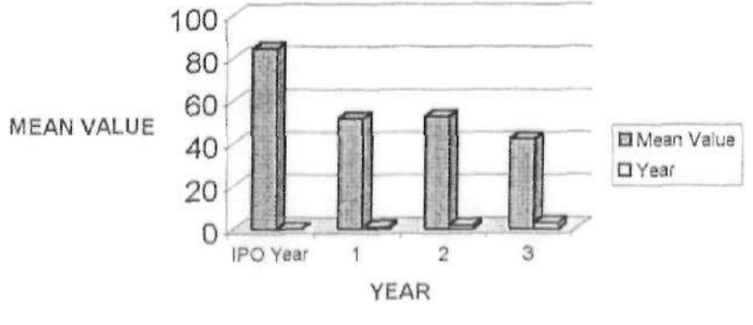


FIG 6b: GEARING FOR SELECTED QUOTED FIRMS POST IPO IN PERCENTAGE

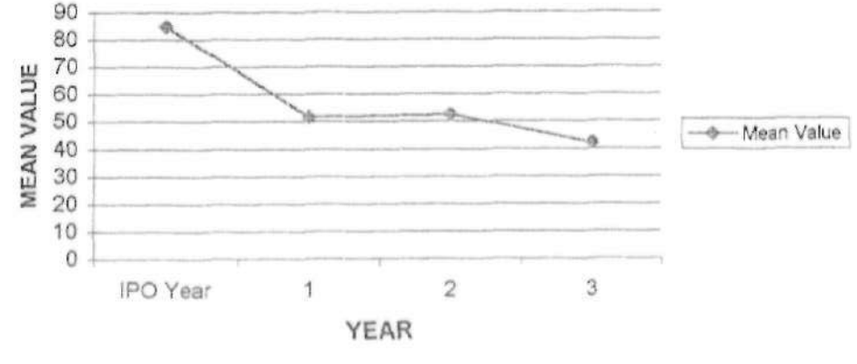


FIG. 7a: FINANCIAL LEVERAGE POST IPO IN PERCENTAGE

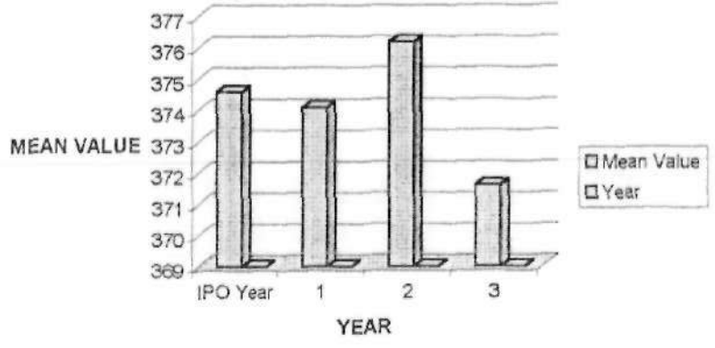


FIG.7b: FINANCIAL LEVERAGE POST IPO IN PERCENTAGE

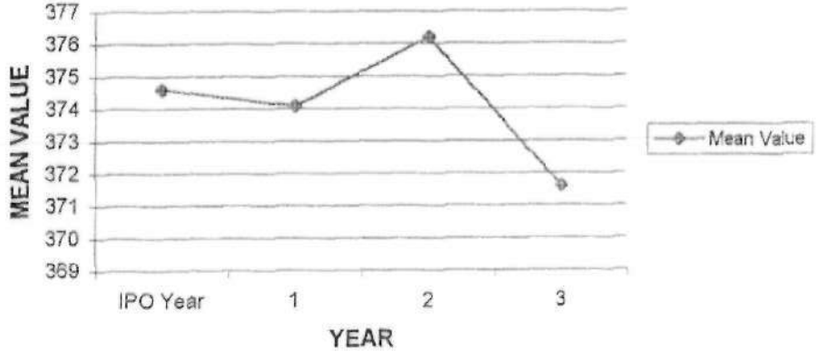


FIG. 8a: OPERATING LEVERAGE POST IPO IN PERCENTAGE

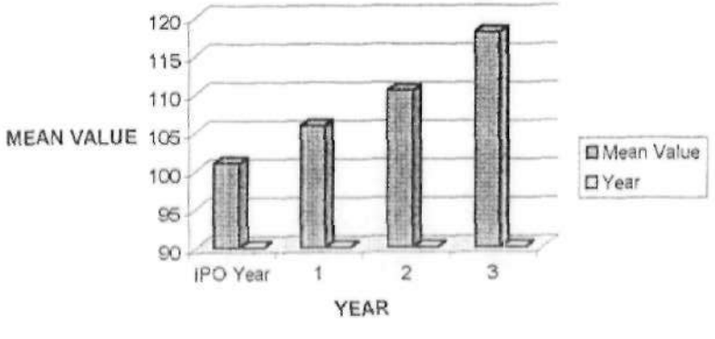


FIG. 8b: OPERATING LEVERAGE POST IPO

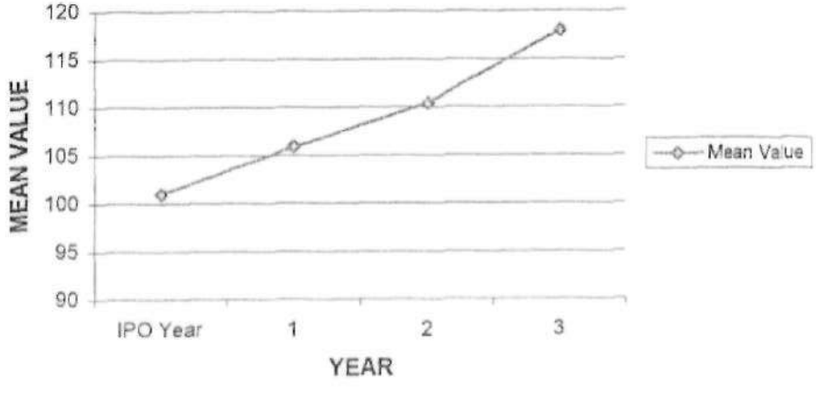


FIG. 9a: RETURN ON ASSETS POST IPO

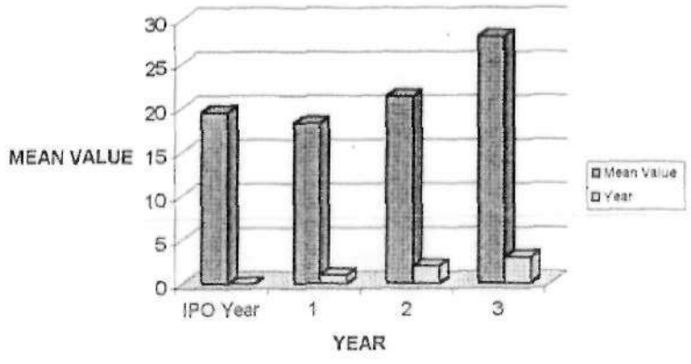


FIG. 9b: RETURN ON ASSETS POST IPO

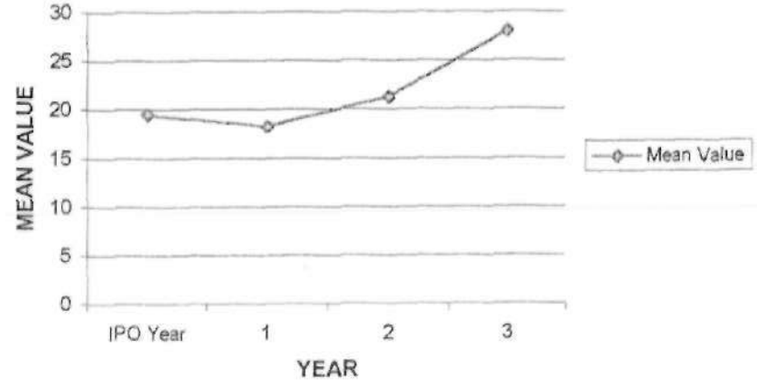


FIG. 10a: OPEARING MARGIN POST IPO IN PERCENTAGE

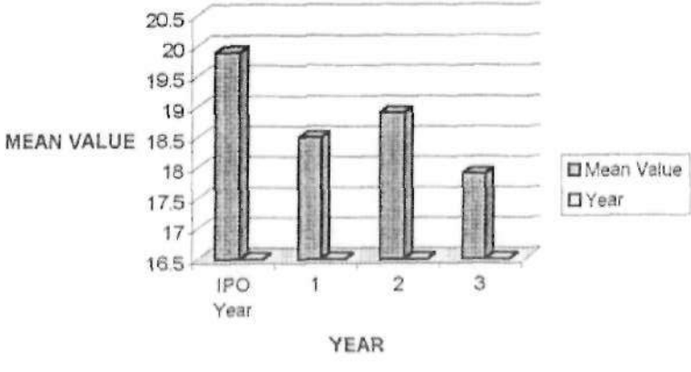


FIG.10b: OPERATING MARGIN POST IPO IN PERCENTAGE

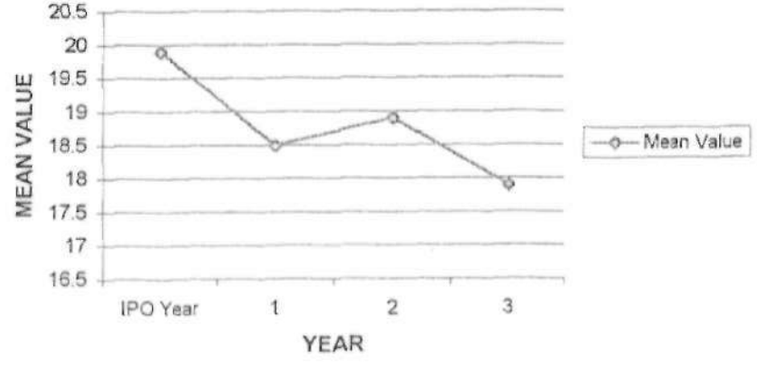


FIG.11a: EARNINGS PER SHARE IN KOBO

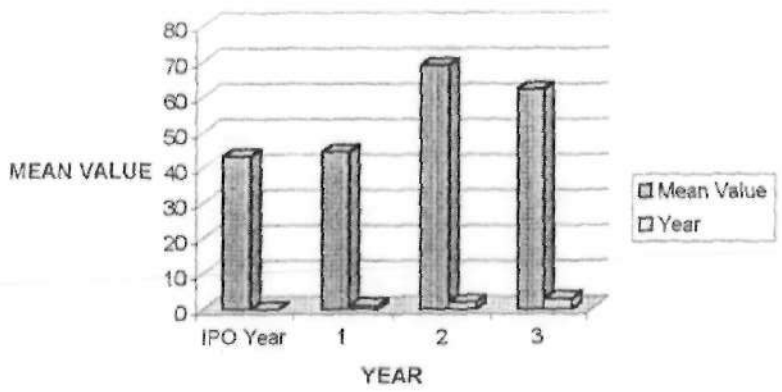


FIG. 11b: EARNINGS PER SHARE POST IPO IN KOBO

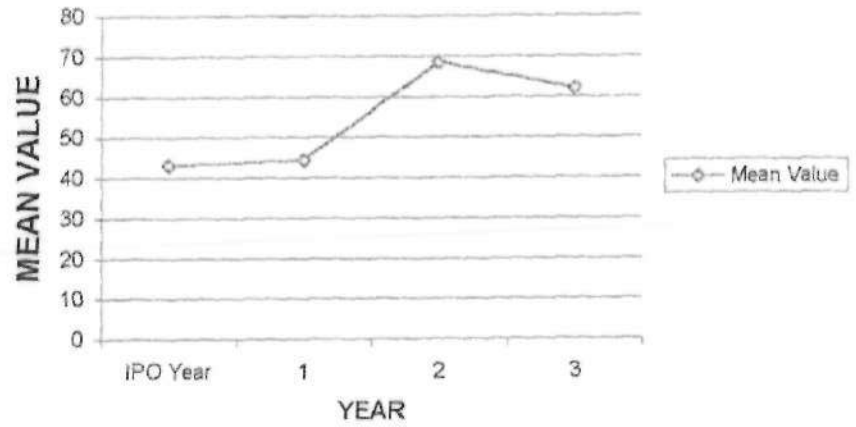


FIG. 12a: DIVIDEND PER SHARE IN KOBO

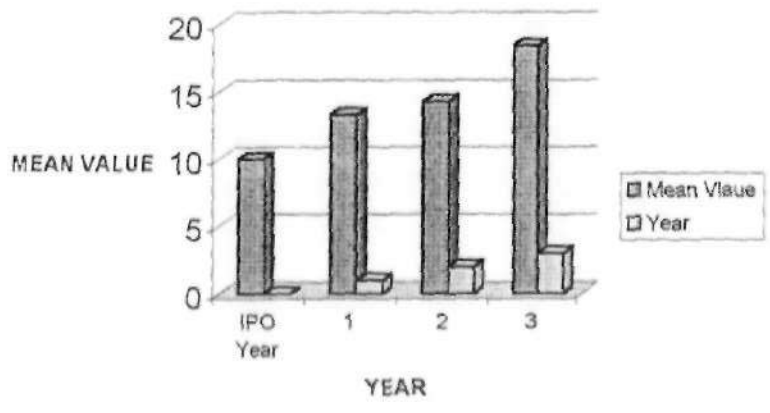


FIG.12b: DIVIDEND PER SHARE IN KOBO

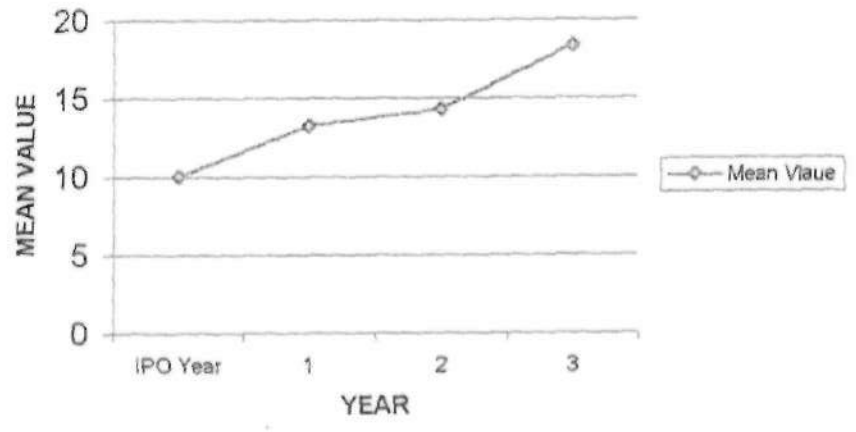


FIG.13a:PAY-OUT RATIO IN PERCENTAGE

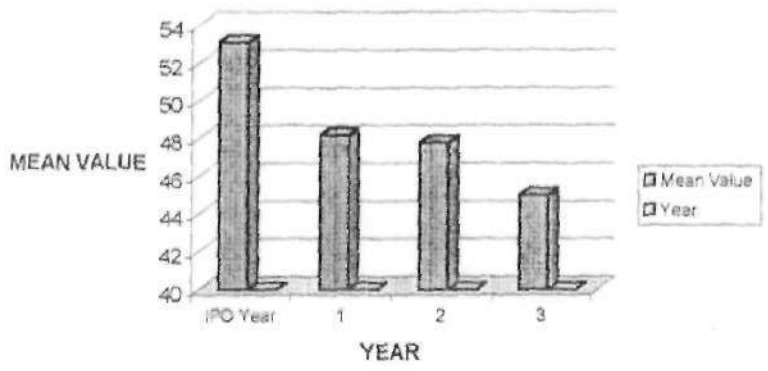


FIG.13b: PAY-OUT RATION IN PERCENTAGE

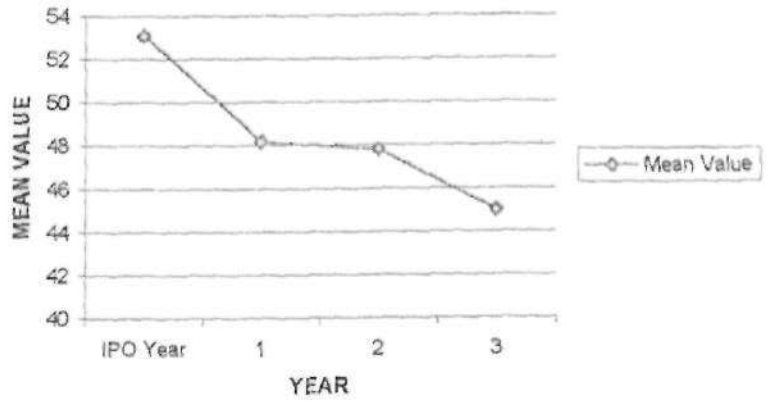


FIG.14a: DIVIDEND COVER (TIMES)

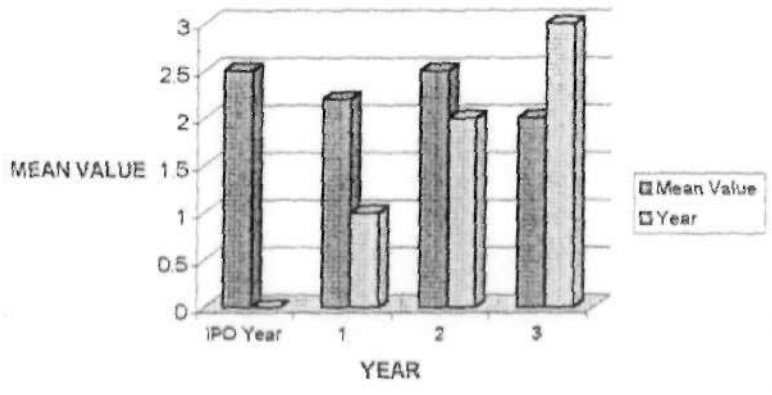
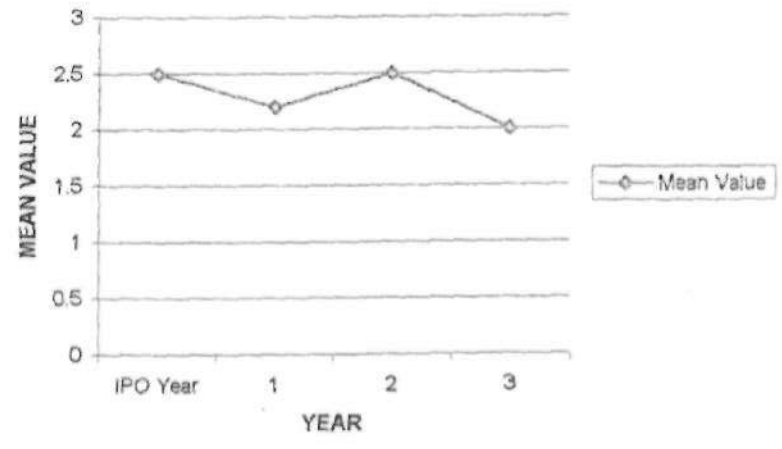


FIG.14b: DIVIDEND COVER (TIMES)



Discussion of Findings

Improved operating performance of IPOs firms indicates that firms in Nigeria make efficient use of their resources three-year pre IPOs. Increasing operating leverage, return on asset (ROA) and operating margin (ROS) implies growth in sales, profitability and efficient use of firm resources pre IPO. This result agrees with the self-reported motivation for IPO in Nigeria. Prospectuses of firms seeking quotation mention a need for fund to take advantage of market growth prospects as a main motive for IPOs. This finding also agrees with Pagano et. al. (1996),who established in a similar study that profitability has a positive impact on the likelihood of IPO. The case of quoted firms in Nigeria does not however agree with Jain and Kini (1994) who documented in U.S.A. a significant decline in operating performance post IPOs. In our research, operating leverage and ROA have upward trends post IPO. The downward trend in ROS in Nigeria is not statistically significant. Therefore, initial public offerings under- performance is definitely not the case in Nigeria. An upward trend in performance post IPO is a further testimony of the quality of Nigerian firms. Dividend cover (DC) post IPO is around the norm of 2. Earning power of shares (EPS) are on the increase while the falling pay-out ratio indicate that firms are relying on internal financing for projects after IPO thus ensuring improved EPS of quoted firms.

Our analysis of ex-post data of IPOs shows that firms seeking initial public offering in Nigeria are highly geared. Financial leverage three years pre IPO are very high and have upward trend. This observation agrees with the finding of Pagano et al. (1996). He noted in his summary statistics of newly listed firms that median IPO firm is more highly levered than medium potential IPO firm.

Analysis of ex-post-financial structure of quoted firms' post IPO shows a declining value for financial leverage in Nigeria. Gearing is seen to have a downward trend meaning that firms deleverage following IPO.

Rydquist and Hogholm (1994) claim in their study that most firms have not used IPO as opportunity to reduce leverage or finance growth. Their report contradicts the self-reported motive in IPO prospectus. It is also at variance with our empirical findings in respect of firms in Nigeria. We concede the fact that the downward trend in leverage has no statistically significance. There is however, an observed significance.

Gearing is abnormally high; the trend is upward in Nigeria pre IPO. The degree of financial leverage affects cost of capital, efficiency, investment and profitability. It determines the degree of risk exposure of firms pre IPO. Among the highly geared firms, incentive to renege on promises is very high thus limiting inflow of investment funds. Pre IPO firms in Nigeria depend on inside equity, trade credit, bank borrowing and possibly retained earnings. This results in a sub-optimally high debt-equity ratio; low credit rating and borrowing constraints. High leverage make these firms insolvent with a high risk of bankrupting. Earnings of firms go to servicing all contractual obligations such as supply contracts, debt servicing, employment contracts and other fixed charges. The option is going to the market to source funds to reduce the risk of bankruptcy. Except where there is substantial growth of market and inflation, high leverage will constraints growth of investment. In the absence of debt guarantee issues, extra capital becomes scarce, bank credit and industrial loans become difficult. Therefore in Nigeria, high gearing affects positively the probability of IPO.

However, the observed downward trend of leverage post IPO in Nigeria, though not statistically significant, contradicts the findings of Rydquist and Hogholm (1994). The use of debt financing depends on the relative cost of debt and equity, interest subsidy, inflation, profitability and the need to maintain control. Other distortations and market imperfection which impact on gearing include differential tax treatment of debt and equity, moral hazards, bankruptcy, information asymmetry and agency cost. Quoted firms may raise leverage because loan become more available at reduced cost will less collateral and better bank services. This is because IPO induces competition among lenders due most probably to greater transparency in accounting reporting and improved image of IPO firms.

Moreover, gearing may rise due to moral hazards as older firms with good track record will often issue both debt and equity instruments in public market. Diamond (1991) predicted that firms will borrow from banks to limit opportunistic behaviour of owners through monitoring.

Differential tax code, which favours dividend and capital gain, will most likely encourage owners to list thereby altering the leverage ratio. Interest costs are tax deductible while dividends are not. With high tax on dividends and capital gain incomes, high leverage ratio may be preferred. The opinion of Chief Executives of unquoted firms on whether they think that tax on dividend income was currently too high to attract them to be quoted, shows that 42% agreed that there is little tax advantage given to quoted firms in Nigeria. In other words, the decision to stay private may be due to current level of tax on dividend income. In our study disclosure was not a deterrence to getting funded in Nigeria. This attitude is not surprising since small firms undertake very little R & D. However, it is observed that

the fear of (R & D) and marketing information spill over to competitors could serve to deter IPO. Moreover, disclosure also exposes them to scrutiny from tax authority thereby reducing the scope for tax evasion (Campbell 1979). They may therefore prefer to go into exclusive bilateral relationship with lenders (Yosha 1995) to avoid information spill over to competitors and tax agents.

From table 15, it is obvious that IPO underpricing deters chief executives from going public in Nigeria. Since 1993, pricing of new issues is made by market operators who can better approximate the true value of securities. However, it is obvious that there is a need for the Issuing Houses to review their pricing mechanism. With increasing profitability of firms preIPO, IPO underpricing is definitely a deterrence to going public. With improved performance pre IPO there is little justification for IPO underpricing. Our research shows that firms in Nigeria are not low quality firms whose profits are about to fall permanently (adverse selection). Therefore, adverse selection cost which is a reason cited for IPO underpricing is not empirically founded in Nigeria. Therefore, registration of more Issuing Houses and Brokers will make the market more competitive since potential IPO firm will have choice to make. Currently the few underwriters in Nigeria act as monopolistic outfits. They hand down uncompetitive prices to their clients.

From table 16, it is obvious that the need to disclose is not the major deterrence for the unquoted forms. They obviously believe that the benefit from quotation out weigh the benefit from non-disclosure. Moreover, we observed that not much R&D are undertaken in these firms. Because of the size of operation some of them marketing strategies of many of these firms are not hidden agenda. Therefore the fear of information spill over to competitors could not pose much problem to them

From table 17 we note that private entrepreneurs in Nigeria want to retain control in their businesses. There are many ways the Nigerian entrepreneurs can be move to retain control even after quotation. The second- tier securities market is design to help such firm retain control. Moreover, firms with sizeable number of share outstanding can introduced such shares without necessarily making offer for subscription. There are instruments, which help initial owners to retain, control e.g. non-voting preference shares. Even ordinary shares can be graded into classes for such purposes.

From table 18, it may be inferred that many of the quoted firms may or may not be having problem with obtaining funds. 33% of those interview were undecided over the issue of credit rating. Many of the firms interviewed are average size firms whose market standing are relatively high in their immediate environment. One may on this ground conclude that the firms rely mainly on bank credit and product market financing for their financing need. Their financial leverage may or may not pose too much problems to their operations. it may be instructive,though to observe that 25% disagreed that they have high credit rating.

From table 19, it is noted that the firms have strong need for external capital for expansion and modernisation. Therefore the decision to remain private is not due to lack of need for funds. One can only postulate therefore that the conditions for entry into the market may be too high for most of them. There may be a need to relax listing conditions that do not directly affect efficiency of operation of the market.

From table 20, the survey indicated that many of the unquoted firms are not satisfied with the level of tax concession given to quote firm. Although capital gains tax was abolished in Nigeria since 1998, the co-existence of corporate income tax and

personal income tax amount to double taxation in the system. There is a need to integrate personnel income tax and corporate tax. Withholding tax on dividends should be reduced also to allow for inflow of foreign investment into the country.

It is obvious from table 21 that the chief executives consider that current bank charges are high. With the current wave of financial deregulation it is not certain that there will be reversal in the short run. It is only hope that many of them will exploit alternative sources of funds.

From table 22 our survey shows that quoted firms in Nigeria consider issuance cost to be high. There is the need to reduce cost of new issue in Nigeria. Currently payment to regulatory bodies, issuing house, brokerages is not competitive. Issuance cost should be tax deductible to encourage smaller firms to list. These include registration fees, underwriting fees, brokers commission, accounting reporting requirements.

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CHAPTER SIX

6.0 SUMMARY AND CONCLUSION

Firms are motivated to seek for initial public offerings. For example, most IPO prospectuses of firms in Nigeria state the need for funds to take advantage of market growth prospects. There are other motivations for initial public offerings. This study proposes a need to alter the structure of corporate governance as a main motive for IPO in Nigeria. A firm is a coalition of many different interests: Shareholder, creditors, employers, managers, suppliers, tax collectors, and customers. Each of the interest groups in a firm exacts pecuniary influence on a firm. Some of a firm's obligations to members of a firm's coalition are contractual. For example payment to owners of fixed rate capital, suppliers, contract employees. In a highly geared firm the risk of insolvency may be very high. Moreover incentive to renege on promises are very high. Therefore, the ability of a highly levered firm to attract sufficient funds at reasonable cost for its projects is reduced. Many projects with high positive returns go un- executed because of inadequate funding. The solution to scarce funds lies in seeking alternative or supplementary sources of fund through changing the structure of ownership and control by going to the market. Therefore, incentive to renege on promises in a highly levered, risk prone firms often mean that a firm will seek to reduce its risk exposure by offering shares to the public. The research shows (i) high leverage pre IPO (ii) an upward and a downward movement in leverage pre and post IPO respectively. The level and trends of financial leverage support the central hypothesis that the need to reduce the leverage ratio is a main factor determining public offering of shares in Nigeria. Moreover ,improved operating performance pre

and post IPO is an indication of the quality of these firms.Our survey of the opinion the chief executives of unquoted firms in Nigeria shows that most of them think that initial public offering underpricing deters them from going public. Most agreed that disclosure is not a deterrence; that there is currently little taxe advantage for listed firms; that issuance cost is on the high side. Majority of them agreed that they need funds. They disagreed that they have high credit rating. They also disagreed that bank charges are low.

The effects of IPO in Nigeria include a reduction in risk exposure, advantage of low corporate and dividend taxes, higher operating margin and greater efficiency in the use of a firms fixed assets, greater asset-turnover and return on asset-ROA. The study also establishes a falling pay-out ratio, which implies greater reliance on internal financing therefore a reduction on reliance on external sources of funds. We also observed increasing earning power of share (EPS) post IPO. Dividend cover is also on the average around the norm . This implies greater shareholders satisfaction.

6.1 RECOMMENDATIONS

Our research analysis and finding call for the following policy options, which we hope, will increase the number of listed firms thereby boosting stock market development in Nigeria. Recommendations include.

1. Proper macro-economic management in Nigeria. Monetary and fiscal policy management could help to reduce the level of inflation thereby reducing relative attractiveness of debt market funding.
2. Equity market funding through stock exchange is made more attractive if all barrier to capital flow (internally and internationally) are removed Barrier such

as political and policy instability, foreign exchange restrictions, withholding tax on dividends must be minimised. This is expected to have positive influence on primary issue in Nigeria.

3. Issuance costs, securities and exchange disclosure rule, percentage of issued share capital in the hand of investing public may further be reduced to make listing more attractive to younger firms.

4. Dividend tax holiday for upward of five years should be given to investors in newly quoted firms.

5. We recommend that there is a strong need for more Issuig Houses, Brokerage firms and underwriters in Nigeria. Nigeria securities firms could invite foreign securities firms to buy some of its share and take up part ownership.

6. There is a need for training Nigeria securities dealers in reputable institutions abroad in order to enhance their efficiency. Members of the regulatory bodies should be trained abroad to enhance their supervisory role over the market.

7. There is a need to attract international investment funds managers of global finances to establish country funds for Nigeria .

8. Also the government must establish domestic investment funds for foreigners. The funds managed by Nigerians for the benefit of non-resident shareholders.

9. The government must collaborate with the private sector in the area of R&D through joint sponsorship of manpower training and research.

10. We recommend that conditions for listing that do not directly affect efficiency of operation of the make should be relax in order to enable many of the firms to get listed.

11. We recommend a reduction in the dividend withholding tax. Personal income tax and corporate tax must be integrated to avoid double taxation. More over, the tax code must make allowance for inflation and The tax must be base on real income and not nominal income.

12. We recommend a reduction in the cost of new issues in Nigeria. Payment to regulatory bodies should be reviewed. Moreover, issuance cost should be made tax deductible.

13. We recommend five-year corporate tax holiday for newly quoted firms. The government may also apply tax penalty for unquoted firm with a significant number of employees.

14. NSEC must have minimum standard for indigenous firms wishing to take advantage of global capital through ADR/GDR.

6.2 RECOMMENDATION FOR FURTHER STUDIES

Our study is by no means exhaustive. A comparative analysis of sector leverage ratios may be undertaken in order to observe sectoral differentials in gearing across industrial grouping of IPO firms with a view to determining the level of risk exposure in various industries pre and post IPO. Secondly, the period of analysis may be extended to include periods beyond three years pre and post IPO. This is expected to enhance the power of generalisation. A research may also be undertaken to determine the effect of specific factors such managerial risks on the decision to seek for public quotation.

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APPENDICES

Questionnaire (Unquoted Firm)

The questionnaire is being administered to selected firms we considered to be qualified for quotation, which nevertheless remain private despite their qualification for listing. The study is an academic exercise; your responses will be kept confidential.

Instructions

Each response is on a five point Likert scale rating. You are expected to circle SA for Strongly Agreed; A for Agreed; U for Undecided; D for Disagreed; and SD for Strongly Disagreed.

1. We stay private for fear of initial public offerings (IPO) Under pricing SA A U D SD
2. We opted to remain private because of the NSE disclosure rule SA A U D SD
3. Owners/Managers decided to remain private for fear of losing control SA A U D SD
4. We do not seek quotation because our credit rating is high SA A U D SD
5. We remain private because we have no need of external Funds SA A U D SD
6. Tax advantages granted to quoted firm are currently low to attract us to go public, SA A U D SA

7.	We consider bank charges very low so we don't need to go public	SA A U D SA
8.	High cost of IPO has prompted us to remain private	SA A U D SA
8.	We remain private so as to reduce visibility to tax authority	SA A U D SA
10.	We remain private for fear of raiders	SA A UD D SA
10.	We remain private because our operation does not put us at risk	SA A U D SA
12.	Issuance cost scare firms from going public	SA A U D SA
13.	Tax on dividend income is currently too high for us to go public	SA A U D SA
14.	We are in good terms with most of our customers	SA A U D SA

APPENDIX A1.1: LONG-TERM DEBT CAPITAL FOR SELECTED QUOTED FIRMS PRE IPO (₦'000)

FIRMS	-3	-2	-1	IPO YEAR
001	22,000	16,000	14,500	10,620
002	27,698	25,876	66,352	92,293
003	40,000	40,000	40,000	40,000
004	1823206	2374832	2604764	2497249
005	1000	5000	500	4615
006	641	1199	1094	1205
007	1063859	2718555	2317060	4198072
008	0	0	0	583
009	503277	1353524	1834166	500819
010	-	-	2500000	2500000
011	1199991	3059991	7169000	4618793
012	6828858	11259227	7760000	8175685
013	0	0	0	0
014	8750834	6720000	5226667	3733334

Source: IPO prospectuses for selected firms

Long-term debt capital = Debentures + loan stock + Preference stock

APPENDIX A1.2: OWNERS EQUITY FOR SELECTED QUOTED FIRMS PRE IPO (₦'000)

FIRMS	-3	-2	-1	IPO YEAR
001	56,966	77,875	106,637	130,730
002	54,185	66,177	99,597	127,266
003	123,549	123,549	201,262	218,001
004	518,142	672,105	1000367	1205829
005	1261	2696	2297	8843
006	12,884	15,132	46109	49619
007	185,164	467,890	905,958	1283334
008	163,746	177,334	207,407	203,250
009	202,999	315,346	436,209	765,196
010	3857146	4578413	9507705	10,268828
011	4444216	5049214	5418769	106665537
012	4237732	13285518	14139522	14694252
013	2728	2926	2965	3079
014	19556039	23141669	28689399	43117694

Source: IPO prospectuses for selected firms

Equity = Ordinary share + statutory and non statutory reserves

APPENDIX A1.3: NET ASSET OF SELECTED FIRMS PRE IPO (₦'000)

FIRMS	-3	-2	-1	IPO YEAR
001	78,966	124,375	162,867	199,229
002	81,883	92,053	165,949	219559
003	1925299	2,780,252	3,813043	4,596,660
004	513,142	672,105	1,000367	1,205,829
005	96,959,037	238485443	381,292,678	391,318,709
006	13,525	16,331	47,203	50,824
007	2,939,793	5830581	6,212,933	9,99,077
008	163,746	177,334	207,407	203,833
009	202,999	315,346	436,209	765,196
010	3,857,146	4578413	9507705	10,268,828
011	4,534,207	8,109,205	12,587,769	15,285,330
012	11,006,590	24,544,745	21,899,522	22,870,637
013	2,728,000	2,926,000	2,965,000	3,079,000
014	30,553,873	32,108,699	38,352,179	51,287,141

Source: IPO prospectuses

Net Asset = Fixed Asset + net current asset

= Share capital + reserves + debentures

APPENDIX: A1.4: TURNOVER FOR SELECTED FIRMS PRE-IPO (₦'000)

FIRMS	-3	-2	-1	IPO YEAR
001	329,916	609,850	656,019	788,306
002	52,361	92,452	49,824	189,974
003	345,166	567,916	611,548	1,079,879
004	1,010,165	1,454,430	1,819,211	2,426,075
005	31,518,129	57,032,221	83,245,735	145,519,596
006	51,377	71,147	94,040	42,887
007	372,325	609,859	1090,897	1,110,275
008	724,758	780,517	771,104	987,996
009	474,110	730,207	888,004	1,503,198
010	8,088,572	9,755,976	14,417,771	23,127,294
011	6,621,471	8,346,920	12,057,951	11,100,596
012	5,675,285	8,401,440	17,551,833	37,412,205
013	5,887	5,787	7,211	6,166
014	50,646,324	76,302,174	94,122,859	149,659,187

Source: IPO Prospectuses (various Issues)

KASHIM IBRAHIM LIBRAR

APPENDIX A1.5: PROFIT AFTER TAX FOR SELECTED FIRMS PRE IPO (₦'000)

FIRMS	-3	-2	-1	IPO YEAR
001	1,483	21,909	33,762	40,093
002	4,824	15,389	26,788	30,883
003	17,265	3,492	5,238	27,217
004	253,228	158,962	373,182	426,198
005	8,348,332	10,423,414	20,118,390	15,145,972
006	4,188	6,248	9,043	3,510
007	153,243	257,726	438,068	377,376
008	92,012	57,508	73,993	40,096
009	130,735	201,509	254,363	464,829
010	372,714	930,398	1,351,095	1,863,329
011	425,555	1,138,188	425,555	266,638
012	139,715	633,707	1,400,726	3,289,038
013	114,000	172,000	35,000	69,000
014	4,873,484	8,085,666	10,047,700	14,428,295

Source: IPO Prospectuses (various Issues)

APPENDIX: A2.1: LONG –TERM DEBIT CAPITAL FOR SELECTED QUOTED FIRMS POST IPO (₦'000)

FIRMS	IPO YEAR	+1	+2	+3
001	25,949	17,675	43,375	330,047
002	86,210	83,491	83,491	83,491
003	42,819	155,244	126,911	116,521
004	14,604	24,653	19,573	23,740
005	0	0	0	0
006	179,862	220,900	282,237	389,879
007	0	0	0	0
008	6,809	9,806	16,041	23,972
009	95,512	89,685	103,700	108,010
010	3,068	6,107	7,954	7,841
011	3,872	2,095	5,000	16,784
012	0	0	0	0
013	0	0	0	0
014	327	0	0	0

Source: Annual reports of selected quoted firms (various issues) Long-term debt capital = Debentures + loan + preference stock

APPENDIX: A2.2: OWNERS EQUITY FOR SELECTED QUOTED FIRMS POST IPO (₦'000)

FIRMS	IPO YEAR	1	2	3
001	20,735	29,733	34,153	86,874
002	241,183	351,547	576,325	789,027
003	216,120	284,597	399,478	681,791
004	3,903	18,539	31,101	36,045
005	8,812	11,466	14,905	31,439
006	0	0	0	0
007	12,187	13,8777	17,456	54,381
008	9,415	11,429	26,866	44,877
009	10,873	14,429	20,310	33,930
010	31,889	41,339	49,310	57,325
011	5,032	11,005	13,720	18,142
012	9,597	11,012	11,331	11,348
013	3,309,027	3,661,084	4,004,271	5,093,192
014	7,599,168	7,923,744	18,769,436	15,169,076
15	14,817	15,765	16,671	18,737

Source: Annual reports of selected quoted firms (various issues) Equity capital

= Ordinary share + statutory and non-statutory reserves

APPENDIX: A2.3: NET ASSETS FOR SELECTED QUOTED FIRMS POST IPO (₦'000)

FIRMS	IPO YEAR	1	2	3
001	328,684	393,105	548,177	954,914
002	327,393	435,038	659,816	872,518
003	258,939	439,481	491,739	793,312
004	20,734	55,224	50,674	59,785
005	8,812	11,466	14,905	31,439
006	192,049	234,777	299,693	444,266
007	23,219	33,925	59,258	86,927
008	23,387	31,277	46,697	73,239
009	42,622	156,331	185,438	218,342
010	8,100	17,112	21,674	25,983
011	13,469	13,117	16,333	34,983
012	3,309,027	3,661,084	4,004,271	34,135
013	7,599,168	7,923,774	18,769,436	5,092,192
014	14,817	15,765	16,677	15,167,075

Source: Annual reports and financial statements (various issues) Net Assets = Fixed Assets + Net Current Assets = Share Capital + Reserves + Debentures

APPENDIX: A2.4: TURNOVER FOR SELECTED QUOTED FIRMS POST IPO (₦'000)

FIRMS	IPO YEAR	1	2	3
001	53,588	59,731	91,606	130,241
002	496,057	578,866	755,288	1,415,563
003	315,046	493,370	731,300	1,122,557
004	14,065	37,817	60,561	108,498
005	15,318	23,874	33,934	43,790
006	90,450	122,451	161,278	237,860
007	23,093	42,946	51,298	69,224
008	37,453	450,613	78,062	116,235
009	45,096	54,035	68,100	96,619
010	6,427	10,532	17,583	129,089
011	4,871	5,345	10,458	13,080
012	3,169,892	3,682,512	5,338,848	9,398,671
013	11,055,231	16,769,205	19,496,509	23,547,209
014	16,766	23,666	32,050	42,537

Source: Annual reports and financial statements (various issues)

APPENDIX: A2.5: PROFITS AFTER TAX FOR SELECTED QUOTED FIRMS POST IPO (₦'000)

FIRMS	IPO YEAR	1	2	3
001	7,009	4,575	11,652	14,484
002	90,428	116,179	158,188	284,978
003	51,407	99,165	114,881	166,283
004	580	2,650	3,775	10,762
005	3,665	4,454	6,814	7,358
006	5,259	1,690	6,779	14,226
007	2,070	2,285	2,320	3,04
008	4,737	4,615	9,621	17,220
009	10,246	16,196	16,412	14,765
010	1,842	2,288	3,764	273
011	221	476	710	515
012	340,597	709,215	878,920	1,802,237
013	186,506	924,606	1,184,140	3,941,323
014	1,578	2,148	2,263	4,039

Source: Annual report and financial reports (various issues)

APPENDIX: A3.1: BUSINESS EXECUTIVES RESPONSE TO WHY FIRMS REMAIN PRIVATE (₦'000)

Firms	IPO Under Pricing	Disclosure	Loss control	High credit rating	Need for external fund	Little tax advantage	Low Bank Charges	High Insurance Cost	Reduce visibility	
001	5	4	5	3	5	2	3	2	3	5
002	2	1	4	5	4	2	4	2	5	4
003	1	5	2	4	5	2	5	2	4	5
004	3	4	3	3	5	4	5	1	4	5
005	2	1	4	1	4	3	5	2	5	5
006	4	2	4	2	5	3	5	2	3	5
007	4	5	2	5	5	3	5	2	4	4
008	2	4	1	4	5	2	5	1	3	3
009	3	4	1	4	4	5	4	1	2	5
010	1	3	2	3	4	2	4	2	1	5
011	1	4	2	2	4	3	4	1	3	4
012	2	5	3	3	3	4	3	3	2	2

Source: Survey

Key: Strongly Agreed = 1

Agreed = 2

Undecided = 3

Disagreed = 4

Strongly disagreed = 5

Quoted Companies by Sector

Agriculture

Ellah Lakes Plc

Grommac Industries Plc.

Livestock Feeds Plc.

Okitipupa Oil Palm Plc.

Okomu Oil Palm Plc.

Automobile & Tyre:

Bewac (Nigeria) Plc.

Dunlop Nigeria Plc.

Incar Nigeria Plc.

Intra Motors Plc.

R.T. Briscoe Plc.

Airlines:

Aviation Development Company Plc.

Banking:

Afribank Nigeria Plc

African Continental Bank Plc.

Allied Bank of Nigeria Plc.

Alpha Merchant Bank Plc.

First Bank of Nigeria Plc.

FSB International Bank Plc

Highland Bank (Nig) Plc.

Inland Bank (Nigeria) Plc.

International Merchant Bank Plc.

Lion Bank of Nigeria Plc.

Mercantile Bank Plc.

NAL Merchant Bank Plc.

Orient Bank of Nigeria Plc.

Owena Bank Plc.

Progress Bank Plc.

Progress Bank Plc.

Savannah Bank Plc.

Trade Bank Plc.

Trans International Bank Plc.

U.B.A. Plc.

Union Bank Nigeria Plc.

Wema Bank Plc.

Breweries:

Champion Breweries Plc.

Golden Guinea Breweries Plc.

Guinness Nigeria Plc.

International Breweries Plc.

Jos International Breweries Plc.

Nigerian Breweries Plc.

Premier Breweries Plc.

Building Materials:

Ashaka Cement Plc.

Benue Cement Company Plc.

Cement Company of Northern Nigerian Nigeria Plc.

Ceramic Manufacturer Nigeria Plc.

Nigercem Plc.

Nigerian Ropes Plc.

Nigerian Wire and Cable Plc.

Nigerian Wire Industries Plc.

W.A. Portland Company Plc.

Chemical & Paints:

Berger Paints Plc.

CAP Plc.

DN Meyer Plc.

IPWA Plc.

Nigeria-German Chemicals Plc.

Premier Paints Plc.

Conglomerates:

A.G. Leventis & Company Plc.

C.F.A.O. Nigeria Plc.

John Holt Plc.

Lever Brothers Nigeria Plc.

P.Z. Industries Plc.

S.C.O.A. Nigeria Plc.

U.A.C.N. Plc.

U.T.C. Nigeria Plc.

Commercial/Services:

Berec International Plc.

Chellarams Plc.

Morison Industries Plc.

Trans-Nationwide Express Plc.

Computer & Office Equipment:

AT & T Global Information Solutions Nigeria Plc.

Atlas Nigeria Plc.

Thomas Wyatt Nigeria Plc.

Tripple Gee and Company Plc.

WTN Plc.

Industrial/Domestic Products:

Aluminium Manufacturers of Nigeria Plc.

Berec Nigeria Plc.

First Aluminium Nigeria Plc.

Industrial Gases Plc.

Liz-Olofin and Company Plc.

Nigeria Enamelware Company Plc.

Nig. Yeast & Alcohol Man. Plc.

Nigerian Lamps Industries Plc.

Oluwa Glass Company Plc.

Vitafoam Nigeria Plc.

Vono Products Plc.

Insurance:

ALLCO Insurance Plc.

Amicable Assurance Plc.

Bri-american Insurance Company Co. Plc.

Crusader Insurance Plc.

Guinea Insurance Plc.

LASACO Assurance Plc.

Law Union and Rock Ins, Plc.

N.E.M. Insurance Co. (Nig.) Plc.

The Niger Insurance Co. Plc.

Prestige Assurance Co. Plc.

KASHIM IBRAHIM L

Royal Exchange assurance Plc.

Sun Insurance Nigeria Plc.

Towergate Insurance Plc.

Unic Plc.

West African Prov. Insurance Co. Plc.

Investment Companies:

First Capital Investment Trust Plc.

Machinery (Marketing):

Blackwood Hodge (Nig) Plc.

Nig. Sew. Machine Man. Co. Plc.

Stokvis Nigeria Plc.

Packaging:

Abplast Products Plc.

Avon Crowncaps & Containers

CMB Plc.

Delta Glass Co. Plc.

Poly Products (Nig) Plc.

Studio Press (Nig) Plc.

Van Leer Containers (Nig) Plc.

W.A. Glass Industries Plc.

Petroleum (Marketing):

African Petroleum Plc.

Afroil Plc.

Agip (Nigeria) Plc.

Mobil Oil Nigeria Plc.

National Oil Co. Plc.

Texaco Nigeria Plc.

Total Nigeria Plc.

Unipetrol Nigeria Plc.

Printing & Publishing:

Academy Press Plc.

Daily Times Plc.

University Press Plc.

Textiles:

Aba Textile Mills Plc.

Afprint Nigeria Plc.

Asaba Textile Mill Plc.

Enpee Industries Plc.

Nigeria Textiles Mills Plc.

United Nigeria Textiles Plc.

Western Textile Mills Plc.

Second Tier Securities:

Adswitch Plc.

Afrik Pharmaceuticals Plc.

Aluminuim Extrusion Industries Plc.

Anino International Plc.

Capital Oil Plc.

Capital Oil Plc.

Cutix Plc.

Flexible Packaging Plc.

Hallmark Paper Products Plc.

Interlinked Technologies Plc.

Juli Plc.

Krobo Nigeria Plc.

Newpak Plc.

Rak Unity Petroleum Company Plc.

Rietzcot Nigeria Plc.

Rokana Industries Plc.

Smurfit Print Nigeria Plc.

Tropical Petroleum Products Plc.

Udeofson Garment Fact. Nigeria Plc.

Union Ventures and Petroleum Plc.

W.A. Aluminium Products Plc.