

Financial, Public and Regional Economics

The Projected Utilization of Initial Public Offer (IPO) Proceeds in Nigeria

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Abstract: Most young private firms use the Initial Public Offer (IPO) method to raise additional external equity fund to finance their growth and later create a secondary market for stocks. This study analysed the projected utilisation of IPO cash proceeds by Nigerian firms with a view to providing investors with information on the most critical areas that firms intend to channel those funds. The study used the cross-sectional data collected by Ilo (2012) on firms that issued IPOs from 1999 to 2009 on the Nigerian Stock Exchange (NSE). The data were analyzed using descriptive statistics such as, the means and percentage and analysis of variance. The results show that the average of IPO price is ₦19.09 per share. About 51% of the net proceeds is projected to be expended on business growth/ expansion and facility acquisition while 20 % is reserved for working capital needs to support the expansion. The initial investors are to enjoy a promoters' cash-out of about 24% of the net cash raised. These projections are laudable investors should interpret the findings with caution since actual deployment of such funds may not necessarily conform with the projections except they are able to ensure adequate monitoring of the managers.

Keywords: business expansion; IPOs; Market timing; net proceeds; projected utilization

JEL Classification: G1; G2

1. Introduction

The Nigeria capital market is still at its infancy given the available indices relative to its age. The Nigeria Stock Exchange (NSE) was established in 1960 as the Lagos Stock Exchange and commenced operations in 1961 with 19 stocks. The market as at December 31, 2012 had only 198 quoted companies with a total market capitalization of N8.9trillion (\$57billion). Usman (1998) observed that thirty five years after the existence of the NSE, only 184 equities were quoted, a number he considered relatively small compared with other emerging markets in Asia and Latin

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America of comparable age. He attributed the smallness of the market to the reluctance of indigenous companies to seek quotations of their companies on the exchange for fear of diluting ownership and loss of control. Oteh (2010) advocates the need to increase the depth, breadth and sophistication of the market by introducing other products like fixed income securities, derivatives, promoting securities lending and investment schemes as the market is currently dominated by equity securities.

An Initial Public Offer (IPO) is the first effort by private firms to raise capital in a public equity market (Carter & Manaster, 1990). Practically, the startup capital of most young firms is often contributed by a limited number of initial owners perhaps having no hope of trading on the stocks if they wish to do so in the future. However, as a firm's operations advance with increasing profitable business opportunities it soon reaches a stage where the fund that could be provided by the existing owners and/or internally generated becomes a limiting factor to growth (Ilo, 2012).

When a company is growing, the biggest hurdle is often raising enough money to expand, but only two options are generally available which is either to borrow money from a bank or a venture capitalist or sell part of the business to investors and use the money to fund growth, but too much borrowing often destroy the balance sheet (Ule, 2007). IPO allows the firm to access the public equity markets for additional capital necessary to fund future growth, while simultaneously providing a venue for the initial shareholders to sell their ownership stake (Kim & Weisbach, 2005). The firm can therefore, be brought to the capital market by a reputable underwriter through a well packaged prospectus while their shares are also offered to the public at an appropriate price to raise the required amount of funds for its developmental needs.

Even though there are usually many reasons why a firm may choose to go public, however, the need to raise enough funds for business growth and expansion has been very predominant. Kim and Weisbach (2005) found that capital -raising is the most important reason for going public. Surprisingly, most studies on IPO have concentrated on the United States of America, Europe, Japan, China. Even, such earlier works have been very limited in scope with most studies concentrating on underpricing of IPO¹. Other authors have concentrated on why firms go public with little or no empirical evidence on how firms propose to use the proceeds of the IPO.

This study therefore, analyses projected the utilization of IPO proceeds by Nigerian firms with a view to identifying and explaining the most critical areas where such funds are to be channeled. Information on utilization of funds to be raised enables

¹ See (Carter & Manaster, 1990; Michaely & Shaw 1994; Beatty, Riffe & Thompson, 2000; Ikoku, 2008).

investors to assess the ability of the firm on delivering on its promises and the potential for the realization of their investment objectives by investing in such IPOs.

The paper is divided into five sections. Section 2 contains the review of literature while the methodology is presented in section 3. Section 4 contains the presentation of the results and summary and conclusion presented in section 5

2. Theoretical and Empirical Review

2.1 Theoretical Issues

An IPO is a special method of raising external finance by a young private firm. Most of the popular theories explaining IPOs are basically extensions of the capital structure theories especially the market timing hypothesis, capital pressure or demand for capital theory and asymmetric information theory. They become suitable since IPOs represent a model of raising funds for firms financing.

The market timing hypothesis posits that the timing of when an IPO is brought to the market has a major role to play on its success or otherwise. The volume of IPOs increases during "hot market" (Ibbotson, Sinderlar, & Ritter, 1994), the total number and value of offers increase over time (Kim & Ritter, 1999; Beatty, Riffe & Thompson, 2000; Altı, 2003). Cogliati *et al* (2008) submitted that about 66% of the IPOs issued between 1995 and 2001 on the Continental Europe were issued in the bubble period of 1999 to 2001 with a higher level of IPO overvaluation during the bubble period than the pre-bubble period of 1995 to 1998. The SEC (2005) in Nigeria also emphasizes submits that if floating is done when there are several issues in the market, the competing demand could adversely affect investors participation as such it has a responsibility of preventing clustering of issues in the market.

The winner's curse hypothesis developed by Rock (1986) is an extension of the asymmetric information theory and argues that firms offering IPOs face the challenge of information asymmetry. One the one hand is the information asymmetry between investors, some of whom are informed and others who are not about the true value of the shares on offer. The outside informed investors are more knowledgeable about the firm's future prospects than the uninformed investor and therefore, bid for more shares of the successful firms while dumping the shares of unsuccessful firms IPOs on the uninformed investors in collaboration with the underwriters.

On the other hand is information asymmetry between original firm owners and potential investors in IPOs. Bachmann (2004) argue that the original shareholders have inside information with respect to the quality of their firm's investment opportunities and many other issues about their firms which are unknown to the outside investor both the informed and uniformed with its attendant consequences. Ariyo (2008) warns that it is risky for investors to rely completely on pre-issue

accounting data projections of Nigerian firms issuing SEOs (*and possibly IPOs*) as the overall predictive accuracy of accounting projections of corporate performance contained in the prospectus is not better than a game of chance hovering around 54 percent.

The proponents of demand for capital theory argue that more generally the demand for external capital usually arise majorly out of the need for capital. For instance, firms with high financial slack (cash and cash equivalent divided by total asset) have lower need for external capital while firms with high asset tangibility are more likely to issue debt (Rajan & Zingales, 1995). DeAngelo, DeAngelo and Stulz (2010) Lowry (2003) find that fluctuations in IPO volume, demand for capital and investors sentiment are important factors contributing to the number of IPOs. The volume of IPOs rises with increase in demand for capital and firms tend to go public when investor's sentiment is high. According to Alti (2003) leverage reduced considerably during the IPO year but most of the effect is reversed in the first year following the IPO and by the second year after the IPO the hot market effect is completely gone.

In summary, these theories thus argue that in order for an IPOs to be successful such that the projected proceeds are realized and perhaps oversubscribed, the issue must be properly timed, and efforts made to minimize information asymmetry between the existing owners and potential investors. Adequate justifications on the need for the fund and more importantly how the funds will be used should be provided in order to motivate investors to subscribe to the issue.

2.2 Empirical Review

The strategies that firms adopt in financing of their operations play a significant role in the success or otherwise of the firm. Such matters like capital structure or debt-equity mix, internal and external financing strategy and when to make a debt or equity issue and its consequences cost are particularly important in explaining the utilization of IPO proceeds.

The account of Rajan and Zingales (1998) shows that industries that require more external finance grow faster in more developed markets from the intuition that financial development affects growth by reducing the differential cost of external finance. Wurgler (2000) finds that financial development improves capital allocation among across industry groups. Love (2001) stressed that financing constraints are generally attributed to capital market imperfections, stemming from such factors as asymmetric information, and incentive problems which result in differences between the cost of internal and external financing. He finds that small firms are disproportionately more disadvantaged in less financially developed countries than are large firms, suggesting that they have relatively larger sensitivity of investment to internal funds. This will allow for easier access to external funds for firms with

good investment opportunities and this improvement in capital allocation will in turn enhance growth.

The corporate financing patterns in developed economies are similar and that generally internal finance is by far the most important source of financing in all the countries sampled while they also have a common financing pattern Mayer (1988, 1990) and Corbett and Jenkinson (1997). Singh and Hamid (1992) find that firms in developing countries use more external finance than the firms in the developed economies. The top corporations in their sample use more equity rather than debt, to finance growth in the 1980s contrary to the patterns found in advanced economies like France, Japan, and Italy where companies traditionally have a relatively greater recourse to external sources of finance. Yartey (2006) finds that quoted firms in Ghana rely more on external sources of fund to finance firm growth than internal sources. External average sources comprise equity 40.68 per cent and debt 47.86 per cent totaling 88.5% suggesting a very limited (11.5%) reliance on internal finance sources..

A firm may go public for many reasons. Brau and Fawcett(2004) find that US firm go public for the following reasons: (i) the single most important reason why firms go public is to create a market so that the firm has a currency of its shares for acquisition.(ii) the need to establish a market price/ value for firm (iii) it is a tool for insiders to cash-out (Black and Gilson, 1998) (iv) to increase publicity /reputation of the company and (v) to allow more dispersion of ownership These findings are said to be in line with the submission of earlier authors like (Zingales,1995; Mello & Parsons, 200, Maksimovic & Pichler, 2001; Chmmanur & Fulghieri, 1999). While Derrien and Kecskes (2006) found that liquidity, anticipation of financing needs, and the desire to raise firm's profile are the most important reasons why U.K firms go public with such reasons ranging between 61 and 71 per cent.

Floation cost is also an important factor for IPO firms. Ritter (1998) indicates that there are a number of direct and indirect costs of going public. In the case of the USA, the average total direct cost of issuing IPOs from 1990-1994, is 11.00 per cent, of the gross proceeds. Kooli and Suret (2002) find that Canadian firm have access to equity capital on a cheaper and competitive scale than the U.S firms especially when the cost of underpricing is included on IPOs issued during 1997- 1999 period. The average direct costs (underwriters' compensation and other expenses) are 11.78 per cent and 10.3 per cent in Canada and the U.S respectively.

Okereke-Onyiuke (1994) finds that the average floatation cost of firm of issues between 1982 and 1988 was about 9.2 % of the amount raised. And Oteh (2010) recently advocates the improvement of cost efficiency and competitiveness of all aspects the Nigerian capital market as high transaction deter companies wishing to enter the market while it is also essential to review the primary and secondary market issues cost.

3. Methodology

In order to provide empirical evidence on the utilization of IPO proceeds in Nigeria, the cross sectional data obtained by Ilo (2012) from the IPO prospectus of 22 out of the estimated 58 successful IPOs issued between 1999 and 2009 on the Nigerian Stock Exchange were analysed. Though the author in the unpublished study acknowledged that it was relatively difficult to establish precisely how many IPOs have been floated in the market during the period, records from the NSE however, indicated that about 208 equity issues were made by way of offer for subscription and offer for sale from 1999 to 2009.

The sample size of twenty-two (22) is considered statistically adequate for the study. In Nigeria for instance Ariyo (2008) used 50 firms out of the 215 quoted firms on the NSE in his study on accounting information and corporate performance in Nigeria. Deloof, Maeseneire and Inghelbrecht (2009) used 49 firms in their valuation of IPOs in Belgium, while Williams and Shutt (2000) used 49 IPOs on the Toronto Stock Exchange (TSE), Canada and 16 IPOs on the TSE were used by Higgins (1994) in the determination of cost effectiveness of Canadian IPOs.

The firms were classified into three groups based on the IPO offer size, viz: small : < N5billion, medium :> N5- N10billion and large: > N10billion. The analytical technique follows the demand for capital theory which argues that issuers need to provide investors with adequate justifications for the amount of funds to be raised and how they intend to use the funds. The analysis of data in this study therefore, focuses on the projected utilization of IPO proceeds based on means and simple percentages while the analysis of variance (ANOVA) test technique was used to test for possible significant differences in the projected IPO proceeds utilization among the firms.

4. Results and Discussion

4.1 IPO Offer Summary

Table 1 presents the IPO offer summary. The total value of the IPOs issued by all the firms in the sample was ₦347.329 billion at an average offer size of ₦15.788billion per IPO.

Table 1. IPO Offer Summary

Descriptive Statistics	Total Sum	Mean	Minimum	Maximum	Coefficient of Variation
Offer Size (₦ billions)	347.329	15.788	1.000	85.000	1.3978
Offer Cost (₦ billions)	16.940	0.770	0.0475	03.496	1.2912
Net Proceeds (₦ billions)	330.389	15.018	0.930	81.504	1.4040
Cost/Offer Size (%)		4.84	0.15	7.20	0.3884
Offer Price (₦. k)		19.09	0.70	100.00	1.74
Firm Age		11.59	0.00	43.00	0.9107

Source: Ilo (2012)

The minimum IPO size was ₦1.0billion and a maximum of ₦85.00 billion. The distribution of the offer size indicates a high level of variability among the firms with a coefficient of variation of 1.40

The total offer cost was ₦16.94billion with a mean of ₦0.770billion. The minimum offer cost was ₦0.0475billion and a maximum cost of ₦496billion per offer. There is a high level of dispersion in the IPO issuing cost given its high coefficient of variation of 1.2912. Cost of offer represents an average of 4.84 per cent of the offer size. The minimum offer cost was 0.15 per cent of offer size with a maximum of 7.2 per cent. The variability of offer cost relative to offer size is very low among the firms with a 0.3884 coefficient of variation.

The net proceed is the balance of funds left after deducting the offer cost from the IPO gross proceeds. The total net proceed is ₦330.389billion. This represents about 95.16 per cent of the offer size. The mean net proceed is ₦15.018 billion with a minimum of ₦0.930billion and a maximum of ₦81.504billion. The dispersion of the individual firm's net proceed value from the mean is rather high with a 1.4040 coefficient of variation.

The average offer price is ₦19.09 with a minimum of ₦0.70 and maximum of ₦100.00 per share. The coefficient of variation of the offer price is 1.74 thus indicating a high level of variation in the IPO prices among the firms.

4.2 Distribution of Offer Size

Table 2 presents the distribution of the offer size classified into three groups, namely, small (less than or equal to ₦5.0billion), medium (₦5.00 – ₦10.00 billion) and large (above ₦10.0billion) offers. Eight firms (36.36 per cent) had offer size of at least ₦5.0 billion with a total offer size of ₦18.50 billion. An average of ₦2.313billion was raised by a typical firm in the small offer size category.

The medium offer size category comprises firms that raised between ₦5.0 and ₦10.0 billion. Six firms are in this category representing 27.28 per cent of the sample. A total sum of ₦42.164 billion was raised by firms in this group while each firm offered an average IPO value of ₦7.027 billion. The firms in the large offer size category (above ₦10.00 billion) jointly raised IPOs valued at ₦ 286.665 billion at an average of ₦35.833 billion per firm. There are eight firms in this group representing about 36.36 per cent of the sample.

Table 2. The Distribution of IPO Offer Size

Offer Size (Naira)	Number of Firms(%)	Total Offer Size (₦' billion)	Average (₦' billion)	Standard Deviation	Coefficient of Variation
Small <=₦5.0billion	8 (36.36%)	18.500	2.313	1.468	0.6347
Medium >₦5.0- ₦10.0billion	6 (27.28%)	42.164	7.027	1.717	0.2428
Large >₦10.0billion	8 (36.36%)	286.665	35.833	26.907	0.7509
Total	22(100)	347.329	15.788	22.066	1.4426

Source: Ilo(2012)

The offer size has been fairly distributed across the groups. However, variations in offer sizes within each group appear too high given the high coefficient of variations of 0.64 and 0.75 in the small and large offer size groups respectively. This disparity becomes more pronounced across the entire sample having a coefficient of variation as high as 1.44.

4.3 Distribution of IPO Offers across Industries

Table 4 shows the distribution of the IPO size and the distribution across industries. The table shows that a total of seven industries appeared in the sample namely: banking, insurance, conglomerate, manufacturing, investment/unit trust, broadcasting and oil and gas. A total of six banks and six investment/unit trust firms are in the sample with each industry representing 27.27 per cent of the sample. The sample contains four manufacturing firms (18.18 per cent) and three insurance companies (13.63 per cent).

Table 3. IPO Offer Size and Industry Distribution

Industry	Small <=₦5.0billion	Medium >₦5.0- N10.0billion	Large >₦10.0billion	Number of firms/ (%)
Banking		2	4	6 (27.27)
Insurance	2	1		3 (13.63)
Conglomerate			1	1 (4.55)
Manufacturing		1	3	4 (18.18)
Investment/ Unit Trust	6			6 (27.27)
Broadcasting		1		1 (4.55)
Oil & Gas		1		1 (4.55)
Total	8 (36.36%)	6 (27.28%)	8 (36.36%)	22 (100)

Source: Ilo (2012)

The conglomerate, broadcasting and oil and gas industries have one firm (4.55 per cent) each in the sample. Thus, more firms in the banking and the investment/unit trust industries issued IPOs during the period compared with other industries.

The distribution of the firms across the offer size shows that only the firms in the investment/unit trust and insurance industry issued IPOs below ₦5.0billion. Only two banks issued IPOs between above ₦5.00 and ₦10.0 billion while majority (4 out of 6) of the banks IPOs were above ₦10.00billion. Majority of the firms in the manufacturing industry issued IPO sizes above ₦10billion while the only one firm in the conglomerate industry had offer size of above ₦10.00billion. The firms in the broadcasting and oil and gas industries in the sample are within the minimum IPO size of above ₦5.01 and ₦10.00 billion bracket.

In conclusion, firms in the banking, manufacturing, conglomerate, broadcasting and oil and gas require huge amount of fund for their proposed post IPO operations and asset requirements hence the need for their IPOs not being less than ₦5.0 billion. However, firms in the insurance and investment/unit trust industries require a relatively smaller equity capital hence majority of them issued IPOs ₦5.00billion and below.

4.5 The Utilisation of IPO Net Proceeds

Table 5 presents the utilisations of net proceeds. The table shows that the firms have a wide range of proposed usage of their IPO proceeds. The proposed usage has been classified into six broad groups for ease of analysis namely: business expansion, facilities acquisition, augmentation of working capital, promoters cash out, business expansion, loan repayment, investment and unit trust business and others.

The most important usage of IPO net proceed is the funding of business growth. This includes the cumulative amount proposed for business expansion, facilities

acquisition and augmentation of working capital requirements accounting for about 71% of the funds raised. The analysis shows the firms proposed to spend ₦106.299billion on business expansion (32.17 %).

Facilities acquisition was meant to take ₦61.141billion (18.51%). The firms also proposed to boost their working capital by ₦66.378billion amounting to a 20.09 per cent of the proceeds. Cumulatively a total of ₦ 171.440billion (50.86 %) was proposed for business expansion and facilities acquisitions to be supported with ₦ 66.378billion working capital (20.09%). By implication the need to finance business growth required them committing a total of ₦ 243.818billion amounting to 70.77% of the IPO net proceeds. This confirms the finding of Kim and Weisbachi (2005) that 79% of all capital raised through IPO in their sample drawn across 38 countries between 1990 and 2003 are from sale of primary shares and concluded that capital raising is an important motive in the going –public decision.

This is followed by the need to create opportunities for promoters to cash out and make opportunistic gain. Insiders cashed out a sum of ₦79.724billion representing 24.13% of the net proceeds involving only three firms. This is in line with the summary of literature by Brau and Fawcett (2004) who confirmed the conclusions of Zingales (1995), Parsons (2000), Andy and Braw(2003) that the need to allow insiders to cash- out and create opportunistic sale for personal gain are part of the important reasons why firms go public. Other proposed means of utilization include investment/unit trust fund establishment (2.87%), loan repayment (1.89%) and other sundry uses including research and development and meeting preliminary expenses (0.34%).

Table 4. Utilisation of IPO Net Proceeds

Proceeds Usage Category	Details	Number of firms	Sub-total Amount ₦'billion	Total Amount (₦'billion)	Net Proceeds Usage (%)
Business Expansion	Business Diversification	1	0.753		
	Branch Expansion	5	7.460		
	Financing Business Acquisition	2	26.502		
	Consolidation/Integration	1	1.669		
	Project Backed Transaction(Pan African Strategy)	1	14.826		
	Equity Investment in Subsidiary	1	4.942		
	Regional Expansion(Pan African Strategy)	2	8.682		

	SBU Expansion	4	39.194	106.299	32.17
	Establish New Business	1	2.271		
Facilities Acquisition	IT Infrastructure	9	27.368	61.141	18.51
	Equipment Fabrication	1	4.500		
	Plant Acquisition	1	3.579		
	Facility/Plant Upgrade	1	0.608		
	Building	1	17.704		
	Digital Satellite System	1	1.702		
	Multichannel/Mobile TV	1	4.700		
	Building of Broadcast Station	1	0.980		
Working Capital		15		66.378	20.09
Sub-total				243.818	70.77
Promoters' Cash Out		3		79.724	24.13
Loan Repayment		1		6.258	1.89
Investment Trust	Real Estate Investment Trust	1	1.911	9.476	2.87
	Securities Investment	4	7.565		
Others	Research & Development	1	1.000	1.133	0.34
Total				330.389	100

Source: Ilo (2012)

The evidence from this study is in line with the theory that most young fast growing firms tend to go public basically to meet the increased capital requirement for business expansion and perhaps provide opportunity for promoters to cash-out. Similarly, an expanding business will require additional investment in fixed assets and working capital to back up the expansion hence the need to commit reasonable part of the funds raised to facility acquisition and working capital.

In order to derive additional insight into the variabilities or otherwise in the proposed utilization of IPO proceeds among the firms the study employed the ANOVA test to establish if there is any significance difference in the proposed utilization of IPO net proceeds. The ANOVA test result indicates that the calculated F-value is 2.544 while the critical value is 2.323 at 5 per cent level of significance. It is therefore concluded that there is a significant difference in the broad distribution of proposed utilization of the net IPO proceeds among the firms, although a convergence when that funds are aggregated into the general usage of business expansion, promoters' cash-out and other sundry purposes.

5. Conclusion

A young private firm after attaining certain growth level often requires huge amount of external capital to finance further growth, an amount that the initial shareholders may not be able to provide. At this stage, the firm may need to approach the capital market to issue an IPO in order to raise the required fresh funds from the public for the first time. There may be other reasons why a firm may issue an IPO like the need to provide opportunity for initial shareholders to cash out, make the stock tradable, strengthen the company's balance sheet for an anticipated future merger and acquisition deal, however, the need for additional huge amount of external capital to finance future growth has been most outstanding.

This study examined the proposed utilization of net IPO proceeds in Nigeria using the cross-sectional data derived from a sample size of 22 IPO issuing firms from 1999 to 2009 extracted from Ilo (2012). In order to achieve the basic research objective, the study adopted simple descriptive analytical technique like means and percentages and analysis of variance for hypothesis testing.

The results show that the average offer price is ₦19.09 with a total proceed of ₦347.34 billion issued at a total cost of ₦16.94billion with a net proceed of ₦330.39billion. This indicates an average offer size of ₦15.79billion and a mean net proceed of ₦15.02billion. The cost of issue relative to offer size is 4.84%.

The analysis of proposed utilization of net IPO proceed shows that the firms intend to allocate about 71% of the proceeds to for the financing of their growth distributed as about 51% for business expansion/facilities acquisition and 20% for the necessary working capital needs. About 24% of the funds is to finance promoters' cash-out.

Conclusively, Nigerian IPO issuing firms varied widely in terms of offer size and proposed utilisation of the net proceeds, however, the strong desire to obtain the huge amount of capital for financing of firms' growth is the major motive for issuing IPOs in Nigeria. It is expected that future studies would compare the projected and actual IPO fund utilization with a view to providing additional insight into this very crucial issue. This becomes expedient, given the finding of Ariyo (2008) that the average actual performance of Nigerian firms is only about 54% of their projected performance indices as contained in their prospectus while attempting to raise external finance.

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