

Full Length Research Paper

Offer for sale by tender: matters arising

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Abstract

Offer for sale by tender is one of the methods of offering ordinary shares of firms to the investing public, by which investors are given the privilege to tender, not subscribe, as they desire. However, this research paper examines some critical issues have arisen from the application of this method. The research is purely theoretical and therefore has used hypothetical figures to address the matters arising. From the theoretical analysis, it was found that the use of offer for sale by tender, as currently practiced is faulty because it abuses the individual intrinsic values of shares and has high chance of the issuing firm losing money, which would usually be recovered through an offer of the shares at a premium. The Paper recommends that the shares should be allotted and allocated by strictly respecting the tenders of prospective investors.

Keywords: Offer Sale Tender, Shares, Investor.

INTRODUCTION

As public or government sector funds shrink in the face of mounting needs, it is apparent that several economies have chosen to concentrate on the provision of the very basic social needs of their citizens. This current wave has resulted in divestment from certain economic activities which were hitherto provided by governments. For instance, between 1986 and 2009, the Nigerian government divested from almost all sectors of the economy (Agundu, 2011). The effect is the expansion of the private sector with mega projects and activities as evidenced in the building, banking and finance, transport and aviation, information and telecommunication, food and beverages, and education. The funding of these mega economic activities requires wider spread of ownership than the sole-proprietor type or the collection of a few high networth individuals that form private limited liability companies. This is evidenced in the movements in volume of securities traded on the Nigerian capital market. For instance, between 1986 and 2010, the number of equities traded in the Nigerian capital market rose from 99 to 217, while government debts reduced from 95 to 47. The result was that the value of government stock as a percentage of the total market value dropped from 95.2% to 0.002%, while other securities increased from 4.8% to 99.998% within the same period (Nigerian Capital Market, 2010). The aim of these changes was to reduce the magnitude of loss

should there be a failure, the reduction of cost of funding given the number of participants in the form of ownership, and the acceptability by the generality of the people as a result of the sense of joint-ownership (Lawal, 2000). This is why firms have chosen to raise ownership (equity) capital or funds by transforming from private limited liability (Ltd) to public limited liability (Plc) (Soludo, 2008). But besides this change from Ltd to Plc some other firms can be established *abinitio* as Plcs in anticipation of the enormity of business to be embarked upon.

Financial management theories have stated that there are many ways of “going public” (Fubara, 2005). For instance, the equity shares of firms can be offered to the public through any of the following ways (Ngerebo-a, 2012; Okafor, 2000; Pandey, 2010):

1. Offer by Prospectus (offer for subscription)
2. Offer for Sale
3. Offer by Stock Exchange Introduction
4. Offer by Stock Exchange Placing
5. Offer by Rights Issue, and
6. Offer for Sale by Tender.

Each of these methods of public ownership of firms has its merits and the merits. Some are most commonly used while others are scarcely used. One of the methods most scarcely used is Offer for Sale by Tender. This paper tries to examine the reasons for the usage of Offer for Sale by Tender as well as the prospects of enhanced

usage of the method for better benefits. The consideration of the better application of the method means that there are some issues and challenges associated with the Sale by Tender which form the basis and title of the paper.

This paper is a theoretical paper that uses the theory of share pricing and hypothetical values to critique the existing theory and practice of Offer for Sale by Tender. The approach used in this research paper is to critically but hypothetically analyze each of the points of matters arising and hence propound alternatives.

Literature

What is offer for sale by tender?

A tender is a method of trading any article, instrument or property, by which someone submits a price without knowing how much another person has submitted for the same article and whoever has put the highest offer will be successful in purchasing the article, instrument or property (Answers International, 2008). Ordinarily, when tenders are made, they come under cover, and when the various tenders are opened the successful buyer will be the highest tender. Sale by Tender is the sale of an asset to interested parties who have been invited to make an offer. The asset is sold to the party that makes the highest offer (Moeller, 2011; Moeller and Brady, 2007). Sale by Tender has been applied to real assets and financial assets for a long time. For instance, Roche (Basel, Switzerland) sold 94% of the shares of Anadys pharmaceuticals at \$3.70 per share in cash by tender (Roche, 2011), just as the USA government sold its 27% of the common shares of Citibank by Sale By Tender in December, 2010 (Citigroup, 2011). In Nigeria, out of the 42 issues of ordinary shares handled by one of the busiest legal advisers registered with the Securities and Exchange Commission (Abdulai, Taiwo and Co.) between 1992 and 2010 only 3 were by Sale by Tender (Cashcraft News, 2011). This means that Offer for sale by tender has not been the very popular method of selling shares on the primary capital market. The unpopularity of this method of offering shares to the public may be as a result of the misapplication of the concept of sale by tender in stock marketing.

Offer for Sale By Tender (SBT) is the method of offering the common shares of a firm to the public in a bid to raise equity capital. It is the method by which a potential shareholder is given the right to apply for a desired or proposed number or units of shares on offer at a share price proposed by the potential investor (Ngerebo-a, 2012). The method is made up of two parts namely the offer part and the tender part.

The first part makes it procedural that shares of a firm be made available to the generality of the investing public, on perceived terms and conditions. Where

potential investor thinks that the proposed terms and conditions agree with what the investor wishes, the investor simply completes an application form indicating the number of units of the shares he/she will want to hold. The completion of the form formalizes the offer which will in turn be accepted by the issuer of the shares (the issuing or offering firm). The offeror (the potential shareholder or the applicant) must furnish consideration before acceptance is made. The consideration is the amount of money posted with the application, for the value of the total number of shares desired.

The acceptance is through allotment made by the issuer or its representative (investment house). That is, if a potential shareholder has applied for 5,000 units at ₦2.00, the firm (issuer) can "accept" to allot the 5000 units or can accept to allocate and allot 3000 units, which means that the difference of 2000 at ₦2.00 must be returned/refunded to the potential shareholder.

The second part in the Offer for Sale By Tender (or simply Sale By Tender (SBT) is the Tender's part, which relates to the prerogative given to an intending shareholder to quote the number of units of shares desired or asked for, and at an intrinsically determined price. In this case the price at which the total number of units offered to the public is completely exhausted becomes the market price of the share. However, all the applicants will be allotted the full number of units applied only if their individual intrinsic ask-price per share is above the price offered by the issuer. This is what financial management theory states.

Illustration

If BB Plc intends to raise ₦20 million from the sale of its shares by tender at the offer price of ₦2.00. Assuming that the following tenders were received from the public, what is the market price of the share issued?

RESEARCH QUESTIONS (MATTERS ARISING)

The above shows the current treatment of offer for sale by tender. However, certain questions are raised from this treatment such as listed below. These questions are what the researcher calls "Matters Arising".

I. If applicants A to F will successfully pay for the units applied at ₦2.00 according by financial management theory (Brigham and Gapenski, 2005; Okafor, 2000; Obara and Eyo, 2010; Peirson, Bird, Brown and Howard, 2005), is the firm (the issuer) not losing revenue by disrespecting and disregarding the intrinsically determined prices of the subscribers and therefore losing premium income from the issue (which should be the difference between the individually intrinsically determined price of ₦2.60 firm pre-determined price of ₦2.00)?

Table 1. Tenders for subscription of shares received

Applicant	Units Applied for	Unit Price
A.	500,000	₦5.00
B.	2,000,000	₦4.50
C.	2,500,000	₦4.00
D.	3,500,000	₦3.00
E.	1,000,000	₦2.75
F.	1,500,000	₦2.60
G.	2,000,000	₦2.00

Table 2. Orthodox allotment of shares based on tender Solution

Applicant	Units Applied	Cum. Units
A.	500,000	500,000
B.	2,000,000	2,500,000
C.	2,500,000	5,000,000
D.	3,500,000	8,500,000
E.	1,000,000	9,500,000
F.	500,000	10,000,000

From the above solution, the market price should be ~~₦2.60~~ instead of ~~₦2.00~~ because the last 500,000 units that make up the needed cumulative units of 10,000,000 shares were tendered at ~~₦2.00~~.

Table 3. Revised cumulative subscription and funds derivable

Applicant	Units Applied	Total Value Payable	Cum. Units
A	500,000	₦2,500,000	500,000
B	2,000,000	₦9,000,000	2,500,000
C	2,500,000	₦10,000,000	5,000,000
D	3,500,000	₦10,000,000	8,500,000
E	1,000,000	₦2,750,000	9,500,000
F	500,000	₦1,300,000	10,000,000
TOTAL VALUE		₦36,850,000	

II. The allotment of the group of units where the cumulative units equals the total number of units on offer by the issuer is also contestable.

III. What should happen to the applicants that quoted/tendered from prices below the market price (the price where the last set of applicants exhaust the total units offered, whether the price is above the offer price or not? That is, since the firm determined price was ~~₦2.00~~ per share, but the 10,000,000 units were consummated at ~~₦2.60~~, what happens to those that tendered at ~~₦2.00~~?

ANALYSIS AND DISCUSSION

From the three points arising from existing theory and practice, the following theoretical analysis can be made.

Point I (Share Allotment Price)

From the example above, it will be seen that Group A applicants have ~~₦5.00~~ as their intrinsic price/value of the common shares, just as B – F have between ~~₦4.50~~ and ~~₦2.60~~ per share. If the groups of applicants are allotted their number of units as tendered and at the tendered

price respectively, the result will be as in the following table 3.

Table 3 shows that:

(a) All groups above the 10,000,000 total units will be allotted the number of units applied for except group F (where rationing will takes place).

(b) Each group of applicants will pay the value for the units applied for at the tendered price, i.e. from

(c) ~~₦2,500,000~~ for Group A to ~~₦1,300,000~~ for Group F as in table.

(d) The firm will generate a total cash of ~~₦36,850,000~~

(e) instead of the ~~₦20,000,000~~ expected. This means a premium of ~~₦16,850,000~~.

(f) The generation of ~~₦36,850,000~~ is mutual and not imposed by the issuer of regulatory agents or investors.

Point II (Allotment in the Last Group for Completion)

From the scenario in table 3 above, Group F investors expressed their desire for 1,500,000 units of shares at ~~₦2.60~~. The matter arising therefore is that the completion 500,000 units will be chosen from the 1,500,000 applicants. According to the rules of the Investment and Securities Act, 1999, all applicants with

lower units of application should have the edge over others. Since the sifting will be tasking, the best option will be a prorated allotment in the ratio of the completion – 500,000 units to the total units of the group (1,500,000 units). This means that 1 unit for every 3 units applied. The refund will therefore be in the ratio of 2 units for 3 units applied or ₦2,600,000.

Point III (What Happens Below Market Price)

From table 3 above, at least 2,000,000 (at most 3,000,000 units) fell below the market (intrinsic) price at

Which the 10,000,000 units of shares were exhausted. In order to solve the dilemma arising from the seeming denial of those that were able to tender at the minimum firm offer price of ₦2.00, the firm can apply to Securities and Exchange Commission or the Nigerian stock Exchange to accommodate the over-subscription, depending on the cost-benefit assessment of increase in the number of units offered.

The effects will include:

- (a) All groups of applicants will be allotted the full number of units at the tendered prices.
- (b) Only applicants with intrinsic prices above ₦2.00 will
- (c) be allotted shares.
- (d) The current market price will be ₦2.60 irrespective of the ₦2.00 offered price.

FINDINGS

1. It shows that the existing practice of allotting shares to successful applicants on the basis of the offer price is faulty because it undermines the personal intrinsic valuations.
2. It found that the current practice of offering or allotting shares at the offer price makes the issuing firm loose cash from the sale unless the shares are allotted at the prices tendered.
3. It shows that given the tenders received, sale by tender provides a quick way of varying the number of units of shares required especially if the cumulative units tendered exhaust the total number of shares offered at a tender price higher than the offer price.
4. This study found that offer for sale by tender is not used as much as other methods like offer by Rights Issue, and offer for subscription.
5. It revealed that the method is consistent with other methods of raising equity capital in the sense that the required number of units of shares can be maintained.

CONCLUSION

We make the following conclusions:

1. The current theory and practice of allotting shares to

applicants, not according to their tendered prices but by offer price, is faulty and denies the process as a true tender.

2. The current theory and practice of offer for sale by tender leads to loss of income for the offer.

RECOMMENDATIONS

1. The researcher recommends that allotment of shares in offer for sale by tender to the public, should be made to successful *tenderers* at the prices they tendered above the benchmark offer price.
2. It is recommended that this change will remove the chances of offering shares at predetermined premiums, and hence bringing the offer price and market price very close to the intrinsic value.
3. It is recommended that this change will encourage competitive pricing and eliminate the problem of fixing share price for the public.

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