Impact of Corporate (Bonus Issue) Action on Stocks in India

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Abstract

Bonus issue is the one of the corporate action where companies issue the stocks to existing shareholders at a free of cost. Bonus announcement or proportion of the bonus may stimulate the investors to buy or sell of the shares before and after of ex-bonus issue date and this may cause the abnormal returns in the stock around ex-bonus issue date. In this paper tries to understand the abnormal returns around ex-bonus issue by using companies which declared ex-bonus issue in the year 2017 in India. Researcher has selected 9 companies randomly from the companies which declared ex-bonus issue in the year 2017 to test the abnormal returns around ex-bonus issue and used event study and t test used to test the significance of bonus issue impact on share price.

Keywords: *Abnormal returns, Corporate actions, Event study, Stocks, Bonus issue*

1. Introduction

A bonus shares are an extra free share given to current shareholders in a company without any additional cost based upon the number of shares that the shareholder already owns. The issue of bonus shares increases the total number of shares issued and owned, it does not increase the value of the company, although the total number of issued shares increases, the ratio of number of shares held by each shareholder remains constant. A bonus issue (or scrip issue) is a stock split in which a company issues new shares without charge in order to bring its issued capital in line with its employed capital (the increased capital available to the company after profits). This usually happens after a company has made profits, thus increasing its employed capital. Therefore, a bonus issue can be seen as an alternative to dividends. Unlike a rights issue, a bonus issue does not risk diluting your investment. Although the earnings per share of the stock will drop in proportion to the new issue, this is compensated by the fact that you will own more shares. Therefore the value of your investment should remain the same although the price will adjust accordingly. The whole idea behind the issue of Bonus shares is to bring the Nominal share Capital in line with the true excess of assets over liabilities Companies issue shares in lieu of consideration. The consideration may be either in the form of cash or kind. Bonus shares are issued by conversion of the reserves and surplus of the company into shares. Bonus shares can be issued only by companies which have accumulated large free reserves i.e. reserves not set apart for any specific purpose and which can be distributed as dividend. However, bonus shares can be issued out of balance in the share premium account.

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1.1 Circumstances for issuing Bonus Shares

If a company wants to avoid showing large amounts of distributable income on the balance sheet and ploughing back its profits to capital, which it has to distribute otherwise, it can use bonus shares. Dividend payment is not obligatory for the company but if the company has huge accumulated profits investors may demand for dividend. Dividend payment entails cash outflow also dividends must be kept stable and should increase gradually. Hence in case of heavy profits to avoid heavy dividend payments company can convert its accumulated profits into share capital by issuing bonus shares. This also perk up market image of the company. If a company can earn more returns than market rate of return, which investors will earn if dividends are distributed to them, then it is advisable to retain the profits by the company itself instead of paying heavy dividends, which will enhance the national income of the country

1.2 Bonus shares issued in the ratio

When the bonus shares are issued in a ratio of 1: 1, it means that one share would be allotted for every share already held in the company. Similarly when a ratio of 2:1 is allocated it means that two shares are allotted for one existing share in the company. As the date is announced then the investors wait for the required date to get the useful benefits. This date is important because the holders of the shares on this particular day will be entitled to the bonus shares. There is another date which should be known by the investors, which is the date when the shares go 'ex-bonus‟. On this day, the share prices adjust in the bonus ratio so that it reflects the actual situation on the ground. Once the price reflects the situation on the ground then the investors will be ineligible for the actual bonus shares. Due to this the ex-bonus date has to be noted carefully.

1.3 How does bonus share affect investors?

Immediately, it doesn’t affect your investments anyway. Post the bonus, the share price should fall in proportion to the bonus issue, thereby making no difference to the personal wealth of the shareholder. However, more often than not, a bonus is perceived to be a strong signal given out by the company and the consequent demand push for the shares causes the price to move up. So, when stock prices move up in the long run, there will be a dramatic increase in the wealth you’re holding.

1.4 Will the share price change after a bonus issue?

A bonus issue adds to the total number of shares in the market. Say a company had 20 million shares with a bonus issue of 2:1; there will be 40 million shares issues. Now the earnings of the company will have to be divided by that many more shares. (Earnings per Share = Net Profit/ Number of Shares)Since the profits remain the same but the number of shares has increased, the EPS will decline. Theoretically, When EPS declines, the stock price should also decrease proportionately. But, in reality, it may not happen.

That’s because:

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i. The stock is now more liquid. Now that there are so many more shares, it is easier to buy and sell.

ii. A bonus issue is a signal that the company is in a position to service its larger equity. What it means is that the management would not have given these shares if it was not confident of being able to increase its profits and distribute dividends on all these shares in the future.

1.5. A Bonus Issue is taken as a Sign of the Good Health of the Company

When a bonus issue is announced, the company also announces a record date for the issue. The record date is the date on which the bonus takes effect, and shareholders on that date are entitled to the bonus. After the announcement of the bonus but before the record date, the shares are referred to as cum bonus. After the record date, when the bonus has been given effect, the shares become an ex - bonus.

Bonus shares are issued by converting the reserves of the company into share capital. It is nothing but capitalization of the reserves of the company

Conditions to Be Satisfied Before Issuing Bonus Shares

- Bonus shares can be issued only if the Articles of Association of the company authorizes a bonus issue. When it is not present in the articles a special resolution should be passed at the general meeting of the company.
- The shareholders should approve in general meeting on the recommendations of BOD of the company.
- The guidelines given by thereby must be followed by. Care must be taken that issue of bonus shares does not lead to total share capital in excess of the authorized share capital. Otherwise, the authorized capital must be increased by amending the capital clause of the Memorandum of association.

1.6 Tax impact on bonus shares

Dividend: Any dividend, interim or final, that is received from an Indian company is not taxable in the hands of the shareholder. However, Indian companies paying such dividends have to pay a dividend distribution tax (DDT) 15% plus surcharge and education cess. Further, dividend and DDT are not tax deductible in the company's hands leading to double taxation of earnings.

Bonus: There is no tax implication when bonus shares are awarded. But when they are sold, they may be taxable, depending on the time for which they are held. The tax man considers the cost of these bonus shares nil.

1.7. SEBI Guidelines

The SEBI has issued guidelines for Bonus issue which are contained in Chapter XV of SEBI (Disclosure & Investor Protection) Guidelines, 2000. A company issuing Bonus Shares should ensure that the issue is in conformity with the guidelines for bonus issue laid down by SEBI (Disclosure & Investor Protection) Guidelines, 2000.

Literature Review

There is mixed evidence regarding the stock market reaction to bonus issue announcement. Researchers have illustrated earlier that the market generally reacts positively to bonus issue announcement. Peterson (1971), Ball, Brown and Finn (1977), Foster and Vickrey (1978), Woolridge (1983), Grinblatt, Masulis and Titman (1984), Healy and Palepu (1988), Lamoureax and Poon (1987), Ikenberry, Rankine and Stice (1996), Ramachandran (1985), Lijleblom (1989), McNichols and Dravid (1990), Obaidullah (1992), Rao (1994), Masse, Hanrahn and Kushner (1997), and Anderson, Cahan and Rose (2001) shown positive market reaction to bonus issue announcement. However, Malhotra, Thenmozhi and Gopalaswamy (2012), Papaioannou, Travlos and Tsangarakis (2000), and Dhatt, Kim and Mukherji (1997) have found the reaction to be negative.

Using monthly data, **Ball, Brown and Finn (1977)** investigated share price reaction around the announcement of 'share capitalization changes' because of bonus share issues, share splits and rights issues in Australia for the period between 1960 and 1969. While they reported 20.2 percent excess return, they failed to provide any statistically significant evidence of price response during declaration period.

Grinblatt, Masulis, and Titman (1984) examined the announcement effect of stock dividends and splits of NYSE and AMEX listed securities from 1967–1976. They noted that equity prices usually respond positively to stock dividend and stock split announcements which are not contaminated by other contemporaneous firm-specific declarations. Besides, they documented significant positive

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abnormal returns on and around the ex-date of bonus issue and splits. However, announcement and ex-date returns were found to be higher for bonus issues comparing to stock splits. They concluded that both stock dividends and splits signals about the future cash flows even when cash dividend is absent.

Lijjeblom (1989) investigated the signalling hypothesis of scrip issues and stock splits for the firms listed with the Stockholm Stock Exchange. In their sample, in 90 percent of the cases, scrip issues and stock splits announcements were contaminated by the simultaneous announcements of other material information. The impact contemporaneous declarations of other material information are controlled by using a control group of otherwise similar stocks but which do not split or distribute a stock dividend. They found notably greater price reactions for the scrip issues and split group than the control group which is taken as evidence for the signalling hypothesis in the presence of contaminating announcements.

Objectives

- To calculate the abnormal returns, average abnormal returns and cumulative abnormal returns
- To determine the impact of bonus issue on stocks average abnormal returns

Hypothesis

H_0: Bonus issue announcement has no impact on stocks average abnormal returns (B=0)

H_1: Bonus issue announcement has impact on stocks average abnormal returns (B≠0)

Research Methodology

This paper is empirical study in nature and used secondary data. Sample size for this research is 9 companies which ex-bonus issue date was in year 2017 and bonus issue ratio is 1:2, for this selection of sample purpose random sampling used. Simple regression model used to find expected returns from the stock and for the market return purpose BSE 500 Index used. Abnormal returns are calculated using stock expected returns and stock actual returns during event period (41 days) i.e. 20 days prior to ex-bonus issue date and 20 days after ex-bonus issue date (-20 to 0 to +20). Student *t* test used to determine the significance of bonus issue impact on stocks abnormal returns.

Simple regression model as fallows

Expected Return (E) = $\alpha + \beta R_M$

α = Alpha coefficient of security with Index;
β = Beta coefficient of the security with Index
R_M= Expected of the return of the Index

Abnormal returns calculated as fallows

$AR = R - E$

R = Actual Returns; AR = Abnormal returns

Average Abnormal returns calculated as fallows

$$AAR = \frac{\sum_{t=1}^{n} At}{n}$$

t = the number of security in the study;
n = total number of stocks in the class

t test used to determine the significance of abnormal returns

$$t = \frac{AAR}{\sigma(AAR)}$$

AAR = Average abnormal return; (AAR) = Standard error of average abnormal return;

Standard error is calculated is (AAR) = $\frac{\sigma}{\sqrt{n}}$

Table 1: Selected companies for study

COMPANY	Bonus Ratio	DATE		
		Announcement	Ex-Bonus	Record
BPCL	01:02	30-05-2017	13-07-2017	15-07-2017
BHEL	01:02	10-08-2017	28-09-2017	30-09-2017
Hind Composites	01:02	10-04-2017	25-05-2017	26-05-2017
HPCL	01:02	26-05-2017	11-07-2017	12-07-2017
Larsen	01:02	29-05-2017	13-07-2017	14-07-2017
Mahindra Holidays	01:02	19-05-2017	10-07-2017	11-07-2017
Motherson Sumi	01:02	19-05-2017	05-07-2017	-
NBCC (India)	01:02	04-01-2017	17-02-2017	21-02-2017
Panama Petro	01:02	14-08-2017	03-10-2017	04-10-2017

Data Analysis & Interpretation

Table 2: Average Abnormal Returns (AAR), Cumulative Average Abnormal Returns (CAAR), and Standard Deviation (SD) and *t* test results of selected sample size during event period

Event Day	AAR	CAAR	SD	SE	t Values
-20	0.373014	0.373	1.25856	0.41952	0.889144

-19	-1.04583	-0.673	1.356205	0.452068	-2.31343*
-18	0.839479	0.167	1.252236	0.417412	2.011153
-17	0.833943	1.001	3.160851	1.053617	0.791504
-16	2.581781	3.582	5.515104	1.838368	1.404387
-15	-1.36604	2.216	2.074405	0.691468	-1.97556
-14	-0.97331	1.243	1.460716	0.486905	-1.99898
-13	0.656868	1.900	1.657885	0.552628	1.188626
-12	-0.81603	1.084	1.046808	0.348936	-2.33863
-11	1.136946	2.221	2.249713	0.749904	1.516121
-10	-0.25072	1.970	1.769735	0.589912	-0.42502
-9	0.392737	2.363	3.205461	1.068487	0.367564
-8	-0.22295	2.140	1.389253	0.463084	-0.48144
-7	0.515072	2.655	1.08795	0.36265	1.4203
-6	0.04735	2.702	1.576707	0.525569	0.090093
-5	-0.25721	2.445	2.102565	0.700855	-0.36699
-4	0.180153	2.625	0.793269	0.264423	0.681305
-3	0.085731	2.711	1.093651	0.36455	0.23517
-2	-0.29422	2.417	1.886113	0.628704	-0.46797
-1	-0.66589	1.751	2.569701	0.856567	-0.77739
(Event day) 0	1.183997	2.935	7.038856	2.346285	0.504626
1	0.09383	3.029	3.109599	1.036533	0.090523
2	-1.12576	1.903	2.732404	0.910801	-1.23601
3	-0.368	1.535	2.454114	0.818038	-0.44985
4	-1.42302	0.112	1.486036	0.495345	-2.87279*
5	-0.81595	-0.704	1.281532	0.427177	-1.91009
6	0.908351	0.204	1.760004	0.586668	1.548321
7	-1.53437	-1.330	1.545212	0.515071	-2.97895*
8	-0.45136	-1.781	0.623425	0.207808	-2.17201
9	0.493285	-1.288	1.932803	0.644268	0.765653
10	0.484385	-0.804	1.387134	0.462378	1.047595
11	-0.22412	-1.028	1.70563	0.568543	-0.3942
12	-0.24577	-1.274	1.211469	0.403823	-0.60862
13	0.887631	-0.386	1.300798	0.433599	2.047122
14	0.080769	-0.305	1.432775	0.477592	0.169117
15	0.732926	0.428	1.379694	0.459898	1.59367
16	0.261767	0.689	2.258785	0.752928	0.347665
17	0.259759	0.949	2.242279	0.747426	0.347538
18	0.754551	1.704	3.7638	1.2546	0.601428
19	-0.13523	1.569	2.46064	0.820213	-0.16487
20	0.138693	1.707	1.88612	0.628707	0.220601

* 5% level of significance 2.306, d.f 8

It is found from table 2 that, stocks average abnormal returns are positive in 23 days and returns are negative in 18 days in out of 41 days window period. Average abnormal return is highest return 2.581781 on -16th day before event day, lowest negative return -1.53437 on 7th day after the ex-bonus day and on event day it was positive return 1.183997. Before event

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day average abnormal returns are little bit high compare to after event day average abnormal returns this thing can be observed in cumulative average abnormal returns also. Cumulative average abnormal returns are positive in 31 days and negative only 10 days in 41 days event window period. Cumulative average abnormal return highest positive 3.582 on -16th day before event window period, lowest negative -1.781 on 8th day after the event window and on event day it is positive 2.935. Cumulative returns are more days are positive before event day compare to after event day cumulative average abnormal returns.

Standard deviation of selected samples average abnormal returns more volatile on event day at 7.038856, less volatile on 8th day after event day at 0.623425 and remaining days of event period average abnormal returns are volatility is not high. Average abnormal returns are negatively significant at 5% level of significance only three days, -19th day before event day and 4th & 7th days after the event, during 41 days window period.

Conclusion

This paper analysed corporate action (Bonus issue) impact on stock prices of nine stocks which ex-split announcement date in 2017 by using stock abnormal returns, cumulative abnormal returns and checking the significance of average abnormal returns with the help of student t test. Samples average abnormal return is positive on event day and average cumulative returns also positive on event day. It can be conclude that investors gained positive average abnormal return on event day but second day after event day investors incurred negative abnormal returns that means investors might have sold stocks on 2nd after the event. It is also observed from research that average abnormal returns are negatively significant at 5% level of significance on three days only during 41 days event period, so it is conclude that corporate action (Bonus issue) impact is not there on stock prices in all most all days around bonus announcement day.

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