An Analysis of Bonus Share Issued and its Impact on Share price with Reference to NSE Listed Stocks in India.

by

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Abstract

When the companies accumulated huge profits and reserves, and it desires to capitalize these profits the companies will go for issuing bonus shares. The other reason is high declaration of cash dividends is prohibited by the Government, so the companies will issue the bonus share, when the higher rate of dividend declared, in the future years also the shareholder will expect the same rate of dividend. When the company cannot have the sufficient cash balance to declare dividends, the company will go for bonus issue. To avoid adverse effects on working capital the companies issue bonus shares.

The objectives of issuing bonus shares is to bring the amount of issued and paid up capital in line with the capital employed so as to depict more realistic earning capacity of the company, to bring down the abnormally high rate of dividend on its capital to avoid labor problems i.e. demand for higher wages, to pay bonus to shareholders of the company without affecting its liquidity and earning capacity of the firm.

This study belongs to Event Study Methodology. The research is done on what happened to the stock price one day before the bonus issue allotment date and what happened to the stock price after one day the bonus issue allotment date.The study had shown a Negative trigger in the stock prices of the selected companies i.e.9 out of 12 companies had witnessed only negative difference during the one day interval before and after the Bonus issue announcement date.Only one company result was found to be neutral. The study was conducted for 12 companies listed in NSE in different sectors from December 2012 to November 2013 by using random sampling method and the statistical tool used is Paired T-test to arrive the result.

Keywords: 1. Bonus Share issue, 2. Stock Return, 3. T-test 4. Bull, 5. Bear

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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 totalnumber 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.

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 issue 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 Is it actually free?

Though, bonus shares don't cost to shareholders technically, bonus shares are not free. Companies do not generally distribute their entire profits to the stockholders as dividends. A fairly large part of the profit is retained and added on to what is commonly called the reserves of the company. Reserves are back up funds which a company keeps for meeting unforeseen increases in expenditure, and for financing its future expansion or diversification programs. But when the reserves have more cash than required for the reinvestment, then companies use these free cash reserves for issuing bonus shares to shareholders. For this, the company transfers some amount of the reserves account to the share capital account by a mere book entry. Bonus shares are issued by cashing in on the free cash reserves of the company. As, shareholders do not pay; the company's profits are also not affected by issuing these bonus shares. Bonus shares increase the total number of shares of the company in the market, i.e. after the bonus issue a company will have more free floating shares in the market. Let's see how. Suppose initially, a company had 10 million shares. This year the company decides to issue bonus shares in 2:1 proportion. With a bonus issue of 2:1, there will be 20 million shares issues in addition to 10 million existing shares in the market. So now, there will be total 30 million shares. This is also referred to as equity dilution. The earnings of the company will also have to be divided by the increased number of shares. Since, bonus issue has no impact on the profit, it remains the same but the number of shares has increased, the EPS will decline.

1.4. 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.

1.5. 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:

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.

1.6. 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 cumbonus. 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.

1.7. 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.

1.8. 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.

2. Literature review

Ramezani, et. Al (2002) Associated corporate performance and shareholder value creation with growth in earnings (or sales) in the investment industry. It had greatly influenced managerial compensation schemes and portfolio decisions. The study sheds light on the relationship between growth and performance by addressing two broad questions. First, what is the relationship between corporate profitability metrics, such as economic value added and the company’s earnings (or) sales growth rate of second, does maximizing corporate profitability necessarily enhance share holder value (as measured by Jensen’s alpha) using multivariate analysis, it was shown that, although the corporate profitability measures generally rise with earnings and sales growth, an optimal point exists beyond which further growth destroys shareholder value and adversely affects profitability. The long run performance of the common stock following straight and convertible debt calls made from

1945 to 1995 which was analyzed by Affleck-graves and Miller (2003). This evidence of over performance following calls shows a distinct symmetry between the straight debt and equity markets. Issues of debt and equity are both followed by long term under performance, whereas stock repurchases and dust seals were both followed by a long run over performance.

The relation between the announcement period returns and the sequence of the seasoned equity offerings for the industrial, financial and utility firms was investigated by Mello and Yaman(2003).They have concluded the firms take advantage of the patterns of announcement period stock returns and asymmetric information levels by raising more capital and by shortening the interval between successive seasoned equity offerings(SEOs) for the issues conducted later in the sequence. Muradoglu and Aydogan (2003) examined the existence of different price reactions to the implementation of stock dividends and rights offerings. Since individual investors, who is attracted by lower relative prices are not expected to be prompt in timing , excess returns persists over longer event windows and are accompanied by increasing trading volumes.Unlike the above study, this study was covering only India based banking and Information technology sector stocks. By the use of event study methodology, the stock price behavior before the bonus share issuing event and after the bonus share issuing event was analyzed by the T-test. This study had been displayed thorough the following objectives.

3. Statement of Problem

Investors would be in confusion in investing their funds in a particular stock because of publicly available information like bonus issues, stock splits etc..Most of the investors feel that once the bonus is issued they may get the profit and market is in good condition.

4. The objectives of the study

- To know the impact of bonus shares issued and its effect on the market.
- To study the bonus share issuing date of Sampled companies

5. Hypothesis

H0-Null Hypothesis-There is no positive impact on share price between one day before and one day after Bonus share issue date.

H1-Alternative Hypothesis-There is positive impact on share price between one day
Before and one day after Bonus share issue date.

6. Research Methodology

For research purpose, this study had taken 12 companies representing various industries listed in NSE.These 12 companies had announced Bonus share issue in their respective annual Board meeting.Since the share price changes had taken bonus share issue as an important cause, the nature of the study adopted was" **Event study methodology**

To carry out this event study methodology, the researcher had taken Paired- T-test as a tool.

7. Data Collection Method

The study was of fictitious in nature; only secondary data were taken for the analysis. These secondary data had been collected from Reserve Bank of India bulletin, National stock exchange Bhav Copy,Journals,Magazines.

8. Sampling Method

- A Random Sampling method is used to select the companies for the year 2012 to 2013
- Sample Size is 12 companies listed in NSE.

9. A Statistical Tool Used.

T-test is the only tool that could determine the amount of changes happened on account of any event

10. Results and Discussion

The analysis and interpretation of data have done was using Excel and SPSS software.

Table 1: Showing the Companies bonus issue date, Ratio and price before and after one day.

Sl No	COMPANY NAME	BONUS ISSUE DATE	RATIO	PRICE ONE DAY BEFORE	PRICE ONE DAY AFTER
1	AGC Networks	19-12-2012	1:1	197.85	193.2
2	Amtex India	21-10-2013	1:1	65.85	70.3
3	Castrol India	04-09-2013	1:1	293.9	273.6
4	Hex aware Technologies	24-02-2013	1:1	59.98	54.1
5	Jyothy Labs	12-07-2013	1:1	124.23	123.75
6	KPIT Cummins Info system	13-03-2013	1:1	93.1	84.9

7	Monsanto India	05-10-2013	1:1	852.6	836.2
8	NALCO	15-03-2013	1:1	119.03	107.9
9	Oil India	29-03-2013	3:2	494.98	509.7
10	Sundaram Finance	13-12-2012	1:1	528.98	514.2
11	SundaramMultipap	13-04-2013	2:1	15.4	15.4
12	Titan India	23-11-2013	1:1	214.62	212

Source:http://www.moneycontrol.com/stocks/marketinfo/bonus

Above table mentioned the various dates on which the bonus share issue was announced by the board of Directors meeting. 1 day before and 1 day after bonus share issue

Table 2: Showing the Companies Positive and Negative differences

Sl No	COMPANY NAME	PRICE ONE DAY BEFORE	PRICE ONE DAY AFTER	Positive Difference	Negative Difference
1	AGC Networks	197.85	193.2		-4.65
2	Amtex India	65.85	70.3	+4.45	
3	Castrol India	293.9	273.6		-20.3
4	Hexaware Technologies	59.98	54.1		-5.88
5	Jyothy Labs	124.23	123.75		-0.48
6	KPIT Cummins Info system	93.1	84.9		-8.2
7	Monsanto India	852.6	836.2		-16.4
8	NALCO	119.03	107.9		-11.13
9	Oil India	494.98	509.7	+14.72	
10	Sundaram Finance	528.98	514.2		-14.78
11	SundaramMultipap	15.4	15.4	0	0
12	Titan India	214.62	212		-2.62

Source:http://www.moneycontrol.com/stocks/marketinfo/bonus/and computed data with a simple calculation

From the above table it shows that 9 companies have shown negative difference, it means that the Bonus issue announcement has decreased the price after one day. Only 2 companies have shown a positive increase after one day and one company has no change with its price i.e netural.

Table 3: Testing for Hypothesis

Paired Sample T-Test

	Mean	**Std Deviation**	**Std Error Mean**	**95%Confidence interval of difference**		**T**	**df**	**Sig.(2 tailed)**
				Lower	**Upper**			
Pair 1 Price one day before-Price one day after	**5.437**	**9.703**	**2.801**	**-0.727**	**11.602**	**1.941**	**11**	**0.078**

Source: Secondary data computed using SPSS 17

The critical value is 2.201with degree of freedom 11 and level of significance 0.05 for two tailed. The calculated value 1.941 is within the critical region. Therefore Null Hypothesis accepted i.e.There is no positive impact on share price between one day before and one day after Bonus share issue date and Alternative Hypothesis is rejected.

11. Findings:

- Most of the bonus issue ratios are 1:1.It meansthat for one share he would be allotted 1share for free.
- Out of 12 companies, 9 shows negative impact and 2 shows positive impact, the remaining one shows no impact i.e. neutral one day before and after the announcement.
- The bonus issue announcement had made the market a negative effect which in turn made the investors to be cautious before investing in it.

12. Conclusion

From this study, it is quite evident that, Bonus share issue has been a powerful financial event which will help improve the stock price and keep the stock in the good books. A Bear was the price depreciation during the bonus share issue in a short period of time. The results were negative;From this we could make out that there were no abnormal returns. Different companies have reacted differently to the news. For some companies the share prices fell before the date of announcement and for some companies it has fallen right after the information was released in the market. The reasons for stock prices to come down before the date of the announcement could be information leakage or actual anticipation.

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