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“““A Study of Bonus Share Announcement effect on Shareholders Wealth in Indian Capital Market”

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ABSTRACT

Bonus shares are part of companies earnings distributed to existing shareholders on freein proportion of their existing holdings in the company. When the bonus is issued to the existing holder it increases the total quantity of shares in the market resulting into no increment in existing market value of the company. The present study is conducted based on Event Study Approach which focuses on how stock prices react (Increase / Decrease) before the announcement, on the announcement day & after the announcement of bonus issue. For diversification, the study analyzed 24 companies of 17 different sectors of Indian Capital Market issuing bonus shares between January 2018 to December 2018. For this, significance level is calculated using t-value. Average abnormal return was calculated, which clearly indicated that there is a significant positive abnormal return to the shareholder before the announcement of bonus issue and significantly negative abnormal return post announcement. The result also indicates that all companies are providing average abnormal return of 1.37%.

Keywords:Abnormal Average Return, Bonus Share Announcement, Event Study Approach

INTRODUCTION

Financial Investment refers to an investment in financial securities like Shares, Bonds, Debentures and Warrants etc. with an objective of gaining profit or return in terms of Dividends, Interest or Capital appreciation in the value of underling instrument[1]**.** Such investments are aligned with the risks called - blockage of capital and a risk of losing that capital. Considering the risk part of the investments various benefits are given to different types of securities.

Common stock / Owner's capital / Equity Shares are the most commonly issued instrument, usually provides a voting right to the holder. Companies reward their common investors for their investments basically in two ways – Dividends and – Capital Appreciations[2]. Dividend is a portion of company's earning which is distributed to its shareholder based on Board of Directors' decision. Distribution of Dividend is done in many forms - A) Cash Dividend B) Stock Dividends & Split C) Property Dividend and D) Special Dividend (extra dividend, spin off, split ups). Out of these forms, companies having large future investments opportunities or not having enough cash generally pay dividend in the form of shares by capitalizing their past profits. Such shares are issued instead of paying dividend in cash, called 'Bonus Share'[3]. Bonus shares are seen by most of the investors as "Gift'' from the companies, even though the legal definition does not enter coin the gift concept. Bonus issues are considered as goodwill gesture and a token of gift from the 'Board' to shareholder. However, gift has Corporate implications[4].

Various studies finding the relationship of Stock dividend and share prices has been conducted in various financial literature of various countries and institutions (equivalent to bonus issues in Australia and script issue in U.K.). Empirical research (in US) propounded that market generally reacts positively to the announcement of bonus issue / stock dividend (US- Foster & Vickrey (1978), Woolridge (1983), Grinblatt et al (1984), and Mcnicholas & Dravid (1990), Canada –Masse et al (1987), NZ - Anderson et al (2001), Sweden - Lijleblom (1989)[5]**.**

Bonus issues are distribution of reserve profits in form of additional stocks to existing shareholders in proportion to their current investment holding in the company. Mainly a company distributes bonus issues out of their Retained Earnings or Accumulated Capital Reserves. It has two ways effect- If a company uses retained earnings for bonus issues, it distributed retained earnings will turn into paid up capital in the stock holders' equity section of the company balance sheet. On the other hand, if a company decides to make a bonus issue from accumulated capital reserves, it turns its accumulated capital reserves into paid-up capital. In both scenario the company does not receive any cash but it result in to book entry with addition of stocks in to each shareholders holding. Though it results in to increase in the shareholders holding in terms of numbers of shares from their previous holding but will not affect their overall proportion in the company, capital structure and financial position of the company. Miller and Modigliani (1961) observed in their studies that bonus issues along with other types of dividends do not alter shareholder wealth. The change that the bonus issue brings is that the numbers of outstanding shares are adjusted by the bonus issue ratio, therefore the price of the securities declines as the numbers of outstanding share increases. The total market value of the shares or the values of the holding by investor remain unchanged[6].

In India, companies have to follow certain guidelines mentioned below issued from Security Exchange Board of India (SEBI), controlling and regulating body for Indian Capital Market, to issue bonus shares[7].

a. Bonus shares can be issued only out of free reserves built out of the genuine profits or share premium collected in cash only. Companies cannot issue bonus shares in lieu of dividend or if it had come out with any public / rights issue in the past 12 months.
b. Bonus issue cannot be issued on partly paid up existing shares.
c. The company should ensure that it has not defaulted in payment of interest or principal in respect of fixed deposits and debentures and in the payment of statutory dues of the employees.
d. Memorandum and Articles of Association are required to be altered if they do not provide the provision of bonus issue in respect of authorized share capital or capitalization of reserves.
e. Companies are required to implement the bonus proposal within a period of 6 months from the date of approval at the meeting of board of directors, and the new shares are to rank *pari-passu* with the existing shares.

LITERATURE REVIEW

Various academicians and researchers from India and across the world have conducted various studies and contributed by their research on the issues of dividend policies and announcement of various forms of dividend like cash dividend, stock dividend and property dividend etc. Miller and Modigliani (1961) in its study with a model explained that issuance of bonus and various types of dividend have no effect on shareholder's wealth. If a company finances its bonus issue from retained earnings then it has to makes a book entry to allocate retained earnings into paid up capital in the balance sheet of a company. Similarly, a company that decides to realize a bonus issue by way of using accumulated capital reserves it had to adjust its accumulated capital reserve in to paid up capital. This leads to no effect on company's cash and financial position, it remains unchanged. The only change that issuance of the bonus issue brings to the company is that the numbers of outstanding shares are adjusted by the bonus issue ratio resulting into decline of share prices. Quotated by Sloan (1987) provided Australian evidence that bonus issues do not affect shareholder's wealth.

Various other empirical researches have shown that the market generally reacts positively to the announcement of a bonus issue / stock dividend. Brown and Finn (1977) observed that stock prices reacts positive to the Bonus Issues, Splits and Right Issues (Stock capitalization changes) in Australian study (Used monthly Data) between 1960 - 1969. They observed the abnormal return of 20.2% for the 13 months including announcement month.

Foster And Vickrey (1978) found significant positive abnormal return on their study of 82 companies by using signaling hypothesis on daily return data.

Woolridge (1983) found a 0.986% positive abnormal ex-date return for a study of 317 stock dividends. Grinblatt, Masulis, and Titman (1984) provided evidence of significantly positive announcement returns of stock splits and large "stock dividend" announcements for the American share markets.

A Canadian study by Masse et al (1997) found significant and positive abnormal return around the announcement date of stock dividend on the value of the firm listed on Toronto Stock Exchange.

In India also various researches have conducted studies to test the effect of bonus issue announcement on the companies in Indian capital market. In the study of Ramachandran J (1995), the bonus announcement effect on equity stock prices was found with mixed evidence of semi strong form in Indian stock market. One of the study by Obaidullah (1992) documented positive stock reaction to equity bonus announcements. He found evidence to support the semi-strong form Efficient Market Hypothesis (EMH)*. Rao (1994) estimated cumulative abnormal return of 6.31%.
Srinivasan (2002) found highly positive abnormal returns on ex-bonus and ex-rights dates for equity stocks. Similarly other studies were condeucted by Singh T., Budhraja I., on BSE suggests that abnormal returns in stock prices with significance level of 95%.

OBJECTIVES OF THE STUDY

1) To study the effect of bonus announcement by the companies listed on National Stock Exchange (NSE) India.
2) To analyze significance of bonus announcement effect (abnormal return/normal return) on selected Indian companies stock prices pre and post period announcement of bonus for the year 2018.

RESEARCH METHODOLOGY

The study comprises the companies satisfy the following criteria.

- Each company is listed on NSE and selected from various groups during the year 2018.
- Daily returns for all companies need to be available for the estimation period, (-150 days to -1 days), Zero i.e. the announcement day and the after event period (0 to + 40 days).

As per the above criterion, there are 24 companies from comprising various 17 sector of NSE was considered as per given in table 1. The bonus stock announcement dates of this sample companies have been collected using two data sources 1) Official Web site of NSE 2) Money Contol.com, for the period from June 2017 to November 2018. First Money control was used to identify the list of Indian companies of various sectors sector that made bonus issue announcement during the specified period.

The null hypothesis in the present study assumed that there is no significant impact of the bonus announcement/ stock dividend declared on the abnormal return of sample companies. The information about announcement reached to common investor over the stock exchanges. Thus, like other announcements, there can be variances in the investor's expectations of the bonus. This is due to the fact that bonus is an indirect way of earning for investor's investment. Therefore, change in investor's expectation from a particular stock. There can be changes in expected return of the same stock and so, it results into abnormal return. The hypothesis has been tested with the help of t-test.

Table 1: Stocks engaged in Bonus announcement in the Year - 2018

Sr. No.	Sector	No. of Companies
1	CONSTRUCTION & CONTRACTING	1
2	BANKING	2
3	TRADING	1
4	PACKAGING	1
5	BREWERIES & DISTILLERIES	1
6	PERSONAL CARE	2
7	FINANCE-HOUSING	1
8	PHARMACUTICAL	1
9	ELECTRIC EQUIPMENT	1
10	Computer / IT - SOFTWARE	3
11	REFINERIES, Oil and Exploration	2
12	GLASS PRODUCTS	1
13	AUTO ANCILLIARIES	3
14	CASTING & FORGINGS	1
15	INSURANCE	1
16	TEXTILE	1
17	MISCELLANEOUS	1

Total		**24**

This study focuses on the market behavior pre and post to the bonus issue announcement. Standard Event Study methodology has been used to conduct Study. An Event study is concerned with the impact of a firm specific corporate event on company's share prices. In order to carry out an Event Study the *event date (Date of announcement), event window (sub periods for pre and post announcement)* and *estimation window (specified time period to calculate expected / normal return)* should be determined. The *Event Date for* this study is the Bonus announcement date by the sample firms, termed as t=0. While the *event window* is taken as t = - 40 to t = +40 relative to the *event date* t = 0. The estimation window is from t = - 100 to t = - 41. To find out the impact of bonus announcement, the present study has focused on the daily closing stock prices of the sample stocks. The daily closing stock prices are taken from NSE website for further process. From the available data of stock price and announcement date, the normal, average, abnormal, and cumulative returns are calculated further.

The normal return of the sample stocks are calculated as:

$$R_{it} = (P_t - P_{t-1}) / P_{t-1}$$

Where, R_{it} = Current day normal return.

P_t = Current day stock price.

P_{t-1} = previous day stock price.

The abnormal return for all the stocks has been calculated using the constant mean return model. After obtaining the mean return of all the sample stock the abnormal return had been calculated following formula:

$$AR_{it} = R_{it} - E(R_{it})$$

Where, A R_{it} = Current Day Abnormal Return

R_{it} = Current Day Normal Return

E (R_{it}) = Expected Return

The calculated abnormal return is further converted into cumulative abnormal return to apply statistical technique. Cumulative abnormal return is calculated for both before and after event date.

$$CAR = \sum_{j}^{n} ARj$$

Where, AR_j= Abnormal return of j^{th} company

The mean CAR is calculated as:

$$\overline{CAR} = \frac{\sum_{i}^{n} CARi}{n}$$

Where, $\overline{CAR}$ = Mean of Cumulative Abnormal Returns.

CAR_i = Cumulative Abnormal Returns on i^{th} day.

n = Number of Days.

The standard deviations for all the stock has been calculated for pre and post announcement event. It is calculated as:

$$\sigma = \sqrt{CAR/n}$$

Where, CAR = Cumulative Abnormal Returns.

n = Number of Days.

STATISTICAL TECHNIQUES

To test the hypotheses in the study, t - test has been applied to find the impact of bonus issue announcement on stock return (abnormal or normal) on sample companies in pre and post time line. The t value is calculated with the formula given below:

$$t = \frac{\overline{CAR}}{\left[\sigma \frac{\overline{CAR}}{\sqrt{N}}\right]}$$

The t - value was further compare to the table value of significance to test the significance of the result.

DATA ANALYSIS AND INTERPRETATION

To study the empirical result of the study mainly 3 tools i.e. mean CAR , standard deviation, t – value have been used. Mean CAR in 15 periods i.e. before and after 40 / 30 / 20 / 10 / 5 / 3 / 1 day from announcement day and of announcement day have been calculated. Standard deviation and t – value has been calculated for the same period and is detailed in table 2.

The trend of CARs for the sample companies over various sub periods has been detailed in table 2. It is clear that during pre announcement period, CARs has been increased from 0.008824% to 1.377696% with some randomness between 5 days pre announcement and 3 pre announcement. These rising trend is an indication of insider trading or informal information leakage. The maximum daily abnormal return is received on the day of formal announcement i.e. 1.377696% with t - value of 2.824673. Which is in line with the results found by Foster and Vickrey (1978), Obaidullah (1992), Lakonishok and Vermalen (1996), Masse et al (1997), Dr. A K Mishra (2005)? For post announcement analysis`, daily abnormal return started decreasing from very next day onwards. It decreases from 1.377696% (announcement day return) to -0.94323% on 40th day post announcement. The reason may be that the expectation of the investors was very high and may be announcement could not match with that expectation. There is some stability found on 20th day but again volatility start as per behavioral science of investor.

Table 2: CARs Measuring the Announcement Effect of Sample Stocks.

Pre and post announcement sub periods	CARs	S.D.	t – value
-40 to 0	0.008824	0.389102	0.111095
-30 to 0	0.001804	0.523472	0.016883
-20 to 0	0.181351	0.535821	1.658085
-10 to 0	-0.02507	0.883254	-0.13905
-5 to 0	0.04837	1.437988	0.16479
-3 to 0	0.156604	2.16877	0.353749
-1 to 0	-0.97299	2.744527	-1.73678
Zero day	1.377696	2.389411	2.824673
0 to +1	1.029616	5.871088	0.859137
0 to +3	-0.56477	2.230759	-1.24029
0 to +5	-0.94157	2.403148	-1.91945
0 to +10	-0.54505	1.259732	-2.11965
0 to +20	-0.27824	0.880365	-1.54831
0 to +30	-0.32254	0.688734	-2.29426
0 to +40	-0.94323	0.664721	-6.95156

**t – value at 10%*

CONCLUSION

From the above analysis, the market behavior after the bonus issue announcement date for 24 stocks of Indian Companies listed on National Stock Exchange in India in the year 2018 was done. An event study was conducted using a 140 day event window. It was found that on an average, the stocks shows positive abnormal returns 40th day before announcement date. This may be the result of information leakage about the announcement. The CARs for all these days are also significant. On the announcement day, there was a highest return of 1.377% and the CARs for the post announcement period is continuously negative. The reason for negative CARs may be the mismatch of the expectation of the investors (high expectations) for returns.

LIMITATION AND FURTHER SCOPE OF STUDY

The sample size of only 24 stocks of 17 sectors restricts the generalization of the results. There may be other corporate announcements with bonus issue announcement by the sample companies which may affect abnormal return which is not considered for the above study. Research can be further extended to conduct insider trading in bonus issue to isolate its effect from market anticipation by segmenting the pre-acquisition announcement period into two parts as explained by Sanders and Zdanowicz (1992). One part would deal with the pre-bonus period beginning from the initiation date when the unpublicized talks of bonus start among the investors while the other part would relate to the pre-bonus period before the actual announcement date. Further, volume of the shares traded before the announcement period (an important indicator of insider trading) can also be studied to decide the extent to which insider trading is prevalent)

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