



# Stock Splits Corporate Announcements-An Empirical Survey in India

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## Abstract:

*A stock split is a decision by company's board of directors to increase number of outstanding shares of the company without changing shareholders equity but by changing face value of equity shares. The current study aims at studying that companies use stock split to bring the price of shares in a range, which can be traded easily by the common investor. We tried to find if stock split is a tool for organizations to increase the number of shares in the market. Attempt was made to find if stock split is used for making the financial ratios lucrative for investors.*

**Keywords:** *Corporate sector, Stock Split, Shareholders*

## 1. Introduction

Stock split is a corporate announcement which has been subject of interest for academicians as well as practitioners and topic of interest in the current study. There is ample scope for academic contributions in this research area, both in terms of appropriately analysing the impact of stock splits and in terms of extending literature by investigating new aspects of the theme.

A stock split increases the number of shares outstanding by reducing the face value of equity shares, without affecting the equity. It must be noted that stock splits are different from stock dividend and bonus issues. In case of stock dividend equity capital of company increases and there is no actual cash outflow.

Some studies suggest that stock splits are done by managers to communicate positive information about future prospects of their company. This hypothesis is termed as signalling hypothesis or information hypothesis. It was first offered by Fama, Fisher, Jensen and Roll (1969). It was later encouraged by researchers like Brennan and Copeland (1988). McNichols and Dravid (1990). and Brennan and Hughes (1991).

Lakonishok and Lev (1987) analyzed corporate performances by examining earnings growth and cash dividend growth. They constructed a sample of splitting companies and a control sample with matching companies with same industry code, similar asset size and used chi-square test to test differences in growth rates. They found that splitting companies exhibited higher growth in earnings and dividends than control companies after split announcement. They also found three to four percent abnormal share price return around announcement day.

Grayson (2005) relied on fundamental theory of supply and demand. He suggested that share price decreases when a company declares stock split and brokers can convince unknowledgeable investors<sup>1</sup> to buy shares with lower prices as compared to share prices prior to split. As a result, underlying shares demand curve moves up and share prices increase. Charitou, Vafeas, and Zachariades(2005) in their study on Cyprus stock market established that investors enjoyed ARs near announcement and ex-

<sup>1</sup> Unknowledgeable investors are those who do not have an idea about stock splits

split day of stock splits. They could not link this behaviour to liquidity or signalling hypothesis. Leung, Meng, and Shuye (2005) for Hong Kong stock exchange examined stock splits from insider trading perspective in order to evaluate signal contained in splits. They noted presence of high insider activity in pre-announcement period and ARs in pre and post event window.

Baker and Gallagher (1980) after interviewing Chief Financial Officers reported that majority of them were of opinion that stock splits are done to attain optimal trading price range which improves liquidity. They also stated that small investors buy at lower share prices and do not like to invest their money when share prices are high. A stock split according to them broadens ownership base of investors.

The need to conduct a study on stock splits arises because existing empirical researches have prompted a series of debates regarding significance and role of stock splits. The present study discusses the results of the empirical analysis conducted in relation to stock splits.

## 2. Objectives of the study

The current study aims at studying the behaviour of share prices around stock splits. The research objectives framed and the research issues examined by the survey are:

1. To investigate the effect of stock splits on share prices.
2. To consider how the stock splits add value to the organization.
3. To examine how the stock splits help the common investor.

## 3. Research hypotheses

To attain research objectives of the current study (restricted to India) following research hypotheses are developed:

HYP: 1-Companies use stock split to bring the price of shares in a range, which can be traded easily by the common investor.

HYP: 2-Stock split is a tool for organizations to increase the number of shares in the market.

HYP: 3- Stock split is used for making the financial ratios lucrative for investors.

HYP: 4-Cost is an important factor in deciding for stock

## 4. Rationale of research hypotheses

The hypotheses relating to share prices try to analyze the behaviour of share prices around stock splits by carrying out a survey in which respondents are the corporate professionals, CEOs, and Managers of the different companies who have announced the Stock split. The survey is conducted to establish the opinion about Stock splits by interviewing the professionals who are responsible for taking a decision for the announcement of stock splits.

## 5. Research methodology

To test the hypotheses enumerated above following research methodology has been designed.

a. For conducting this study, data was collected from the primary sources (data collected directly from the respondents with the help of a self-administered questionnaire).

b. The study was conducted in various cities of India, viz., Delhi, Mumbai, Gurgaon and Faridabad. The following discussion relates to the sampling process: sample size, characteristics, research setting and sampling technique. Questionnaires were distributed to 55 respondents. Of these 35 usable questionnaires were collected indicating a response rate of 64% approximately.

**5.1 Respondents included in the sample were selected to meet specific criteria like**

1. They should be a professional or any other person working on a managerial post and directly involved in decision –making relating to the announcement of stock splits.
2. They could be male or female.
3. They should be willing to participate.

Non-probability method of sampling was used along with quota and convenience sampling methods. The questionnaires were administered both in person as well as through personalised e-mails with attached questionnaire in HTML format, which could be filled and submitted online to the researcher. Respondents were assured of their anonymity throughout the conduct of the research. Respondents were approached in corporate offices and banks with the questionnaires for data collection. Those respondents to whom the questionnaires were mailed were requested via phone call also to participate in the survey. To increase the response rate, the respondents were repeatedly reminded to complete the questionnaire.

**6. Sample Description**

From the following table can observe that about 48.6% of the respondents belonged to 22 – 24 years age group. Following bar chart also shows the same.

**Age**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 22 – 24	17	48.6	48.6	48.6
25 – 34	7	20.0	20.0	68.6
35 – 40	6	17.1	17.1	85.7
40 - 60	5	14.3	14.3	100.0
Total	35	100.0	100.0	

From the following table we can observe that about 71.4% of the respondents were males.

**Gender**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Male	25	71.4	71.4	71.4
Female	10	28.6	28.6	100.0
Total	35	100.0	100.0	

From the following table we can observe that about 45.7% of the respondents were graduates.

**Qualification**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Graduate	16	45.7	45.7	45.7
Post-graduate	7	20.0	20.0	65.7
Masters	8	22.9	22.9	88.6
Other	4	11.4	11.4	100.0
Total	35	100.0	100.0	

From the following table we can observe that about 54.3% of the respondents answered that their organization is a large organization with 200 employees or over.

**Organization size**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Small-size organization (Less than 60 employees)	8	22.9	22.9	22.9
Medium-size organization (60-199 employees)	8	22.9	22.9	45.7
Large-size organization (200 employees or over)	19	54.3	54.3	100.0
Total	35	100.0	100.0	

**7. Research Instrument**

Data were collected with a help of undisguised questionnaires. The scale items were taken from the previous research work and adapted to make them appropriate to the Indian context. Structured undisguised questionnaire was used for data collection. Five point Likert-scale anchored at both extremes to 1 (strongly disagree) and 5 (strongly agree) was chosen to represent the degree of consumer responses. Likert-type or frequency scales use fixed choice response formats and are designed to measure attitudes or opinions. These ordinal scales measure levels of agreement/disagreement. Respondents were offered a choice of five pre-coded responses with the neutral point being neither agree nor disagree.

**8. Reliability Testing**

Reliability is the degree of consistency with which an instrument measures the attribute it is designed to measure. Cronbach’s Alpha test was used in the research to test the reliability of the scales used. A Cronbach Alpha coefficient equal or greater than 0.6 indicates that the scale is reliable (Nunnally, 1978). Cronbach’s Alpha coefficients for all the scales except recreation orientation, experience orientation and convenience orientation are far above the threshold limit of 0.6 and hence, were found to be highly reliable.

**9. Pretesting the Questionnaire**

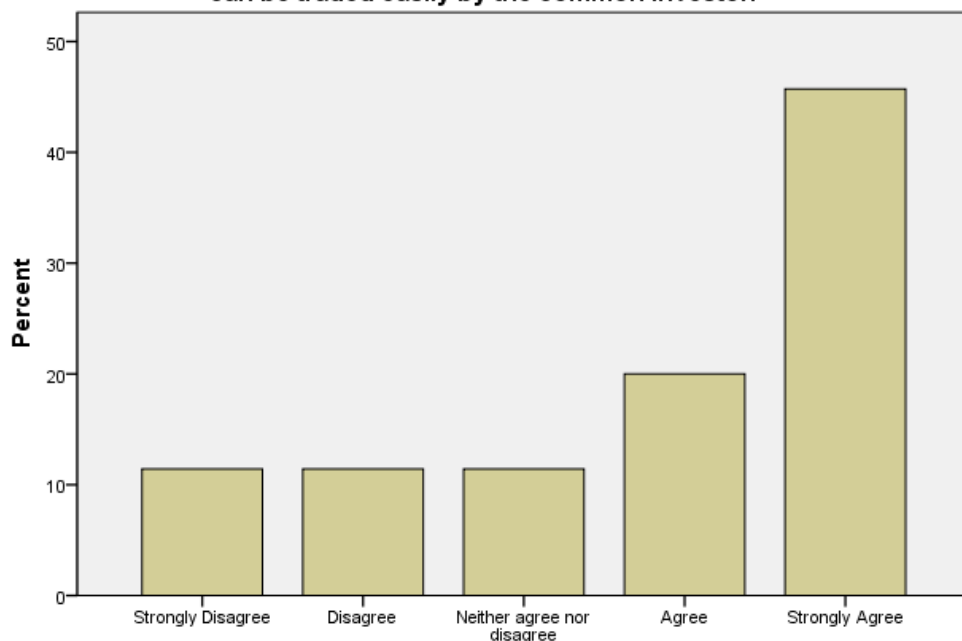
A pretest refers to a trial administration of the questionnaire to determine whether questions and directions are clear to subjects and whether they understand what is required of them. The questionnaire was pretested on 5 respondents meeting the sample criteria. The results of the pre-test were found to be satisfactory enough to continue with the main survey. **The results of the statistical analysis are as follows.**

From the following table we can observe that about 45.7% of the respondents strongly agreed that companies use stock split to bring the price of shares to a medium range, which can be traded easily by the common investor. Following bar chart also shows the same.

**Companies use stock split to bring the price of shares to a medium range, which can be traded easily by the common investor**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Disagree	4	11.4	11.4	11.4
Disagree	4	11.4	11.4	22.9
Neither agree nor disagree	4	11.4	11.4	34.3
Agree	7	20.0	20.0	54.3
Strongly Agree	16	45.7	45.7	100.0
Total	35	100.0	100.0	

**Companies use stock split to bring the price of shares to a medium range, which can be traded easily by the common investor.**



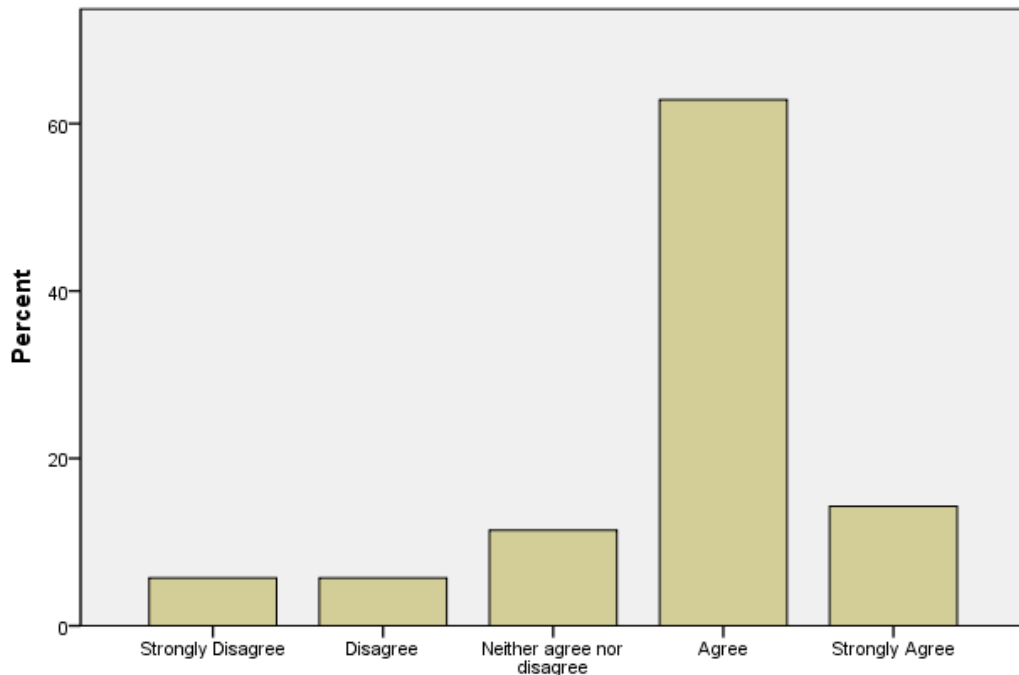
**Companies use stock split to bring the price of shares to a medium range, which can be traded easily by the common investor.**

From the following table we can observe that about 62.9% of the respondents agreed that stock split is a tool for organizations to increase the number of shares in the market. Following bar chart also shows the same.

**Stock split is a tool for organizations to increase the number of shares in the market.**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Disagree	2	5.7	5.7	5.7
Disagree	2	5.7	5.7	11.4
Neither agree nor disagree	4	11.4	11.4	22.9
Agree	22	62.9	62.9	85.7
Strongly Agree	5	14.3	14.3	100.0
Total	35	100.0	100.0	

**Stock split is a tool for organizations to increase the number of shares in the market.**

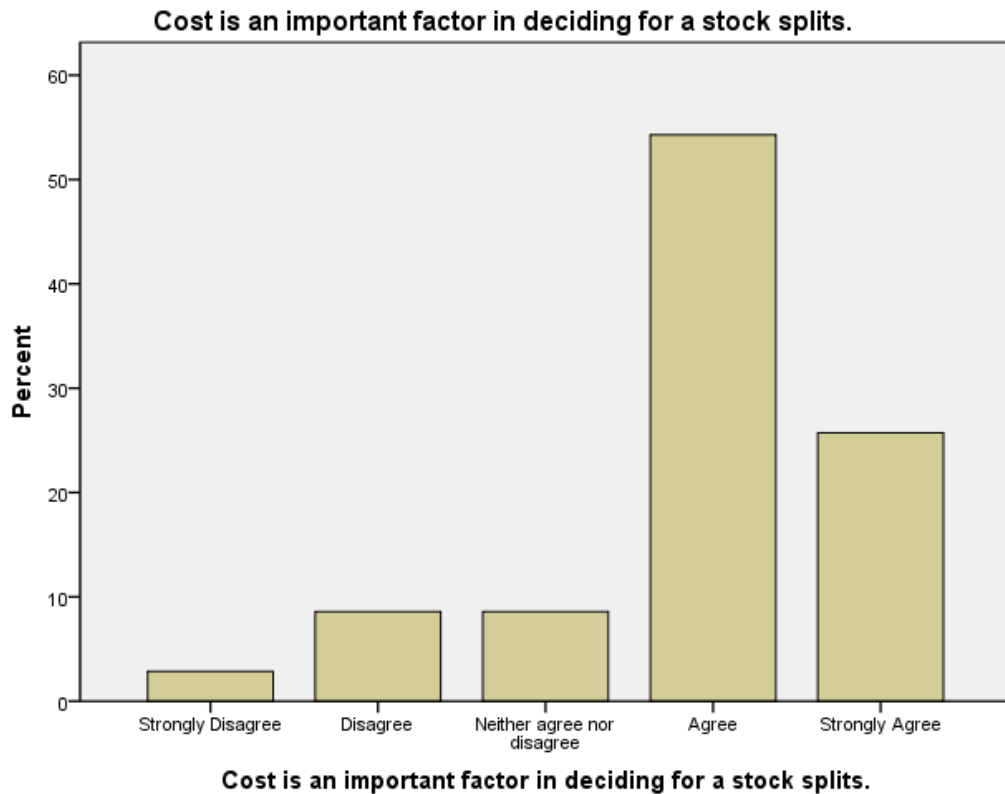


**Stock split is a tool for organizations to increase the number of shares in the market.**

From the following table we can observe that about 54.3% of the respondents agreed that cost is an important factor in deciding for stock splits. Following bar chart also shows the same.

**Cost is an important factor in deciding for a stock splits.**

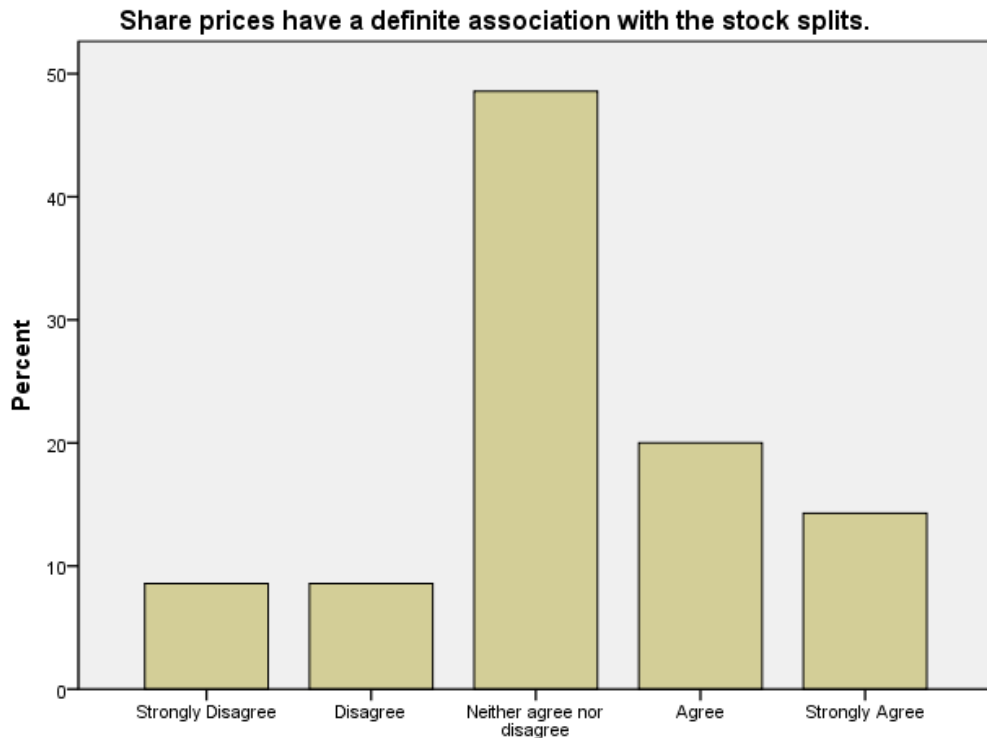
	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Disagree	1	2.9	2.9	2.9
Disagree	3	8.6	8.6	11.4
Neither agree nor disagree	3	8.6	8.6	20.0
Agree	19	54.3	54.3	74.3
Strongly Agree	9	25.7	25.7	100.0
Total	35	100.0	100.0	



From the following table we can observe that about 48.6% of the respondents neither agreed nor disagreed that share prices have a definite association with the stock splits. Following bar chart also shows the same.

**Share prices have a definite association with the stock splits.**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Disagree	3	8.6	8.6	8.6
Disagree	3	8.6	8.6	17.1
Neither agree nor disagree	17	48.6	48.6	65.7
Agree	7	20.0	20.0	85.7
Strongly Agree	5	14.3	14.3	100.0
Total	35	100.0	100.0	



**Share prices have a definite association with the stock splits.**

## 10. Discussion of Analysis

Most of the respondents who participated in the study said that the stock splits the company in adding value to the company and in the increasing of the market capitalization. So they were asked that whether the companies are using stock split to bring the price of shares to a medium range so that it can be easily traded by the common investor. For that around 34.5 percent of the respondents who participated in the study said that they agree that the stock splits are used by the companies to bring the price of shares to a medium range so that it can be easily traded by the common investor. And 30.9 percent of the respondents who participated in the study said that they strongly agree that the stock splits are used by the companies to bring the price of shares to a medium range so that it can be easily traded by the common investor. That is more than 60 percent of the respondents who participated in the study accept that the stock splits are used by the companies to bring the price of shares to a medium range so that it can be easily traded by the common investor. This shows that the stock splits help the companies to bring down the share prices to medium range so that the common investor can easily trade with those shares.

Once most of the respondents who participated in the study agreed that the stock splits the company in adding value to the company and in the increasing of the market capitalization, then they were asked that whether the stock split is a tool for an organization to increase the number of shares in the market. For that, around 40 percent of the respondents who participated in the study said that they strongly agree that a stock split is a tool for an organization to increase the number of shares in the market. And around 32.7 percent of the respondents who participated in the study said that they agree that a stock split is a tool for an organization to increase the number of shares in the market. So, more than 70 percent of the respondents who participated in the study said that the stock split helps an organization to increase the number of shares in the market. Thus, it is inferred that to increase the number of the company's shares in the market; an organization can use the splitting of the stock as a tool. When the respondents who participated in the study said that the share prices have a definite association with the stock splits, then they were asked that the weather share prices do not adjust fully in proportion to the split ratio. For that around 41.8 percent of the respondents who participated in the study said that they agree that the share prices do not adjust fully in proportion to the split ratio. And around 29.1 percent



of the respondents who participated in the study said that they strongly agree that the share prices do not adjust fully in proportion to the split ratio. That is, more than 70 percent of the respondents who participated in the study said the share prices do not adjust fully in proportion to the split ratio. This shows that with the proportion of the split ratio the share prices will not fully get adjust.

## 11. Conclusion

- The stock splits made by a company will add value to that company and also with the increasing number of shares in the market it helps in the increase of the capitalization of the company.
- The stock splits help the companies to bring down the share prices to medium range so that the common investor can easily trade with those shares.
- To increase the number of the company's shares in the market; an organization can use the splitting of the stock as a tool.
- The stock split made by an organization will create a positive influence on the price of the shares.
- During the judging of the stock splits by an organization the cost is considered as an important factor.

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