INTERNATIONAL JOURNAL FOR INNOVATIVE RESEARCH IN MULTIDISCIPLINARY FIELD
ISSN: 2455-0620 [Impact Factor: 6.719]
Monthly, Peer-Reviewed, Refereed, Indexed Journal with IC Value : 86.87
Volume - 8, Issue - 2, FEB - 2022 Publication Date: 28/02/2022

DOIs:10.2015/IJIRMF/202202006 --:-- Research Article

"Stock splits- what, why, who and when"

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Abstract: *Stock split is a corporate action and announcement as like an issue of bonus, rights, warrants, decisions like merger/demerger, amalgamation, consolidations, hive-off , secured premium notes (SPNs) among others and declaration of dividend. Splitting of stock is a decision taken by companies that want to increase number of outstanding shares by reducing face value of shares to attract and make shares more affordable to the investors and to boost up liquidity of stock. The present study was analysed the concept, types of stock split and theories relating to stock splits and also investigated empirically why companies split their stock and at what circumstances usually firms are going to announce stock splits. The study also analysed the implications and consequences of splitting of stock and presented the stock splits scenario in India from 2001-2021.*

Keywords: *Stock split, Corporate action, Liquidity, Shareholders base, Affordability, Reverse stock splits, Outstanding number of shares.*

1. INTRODUCTION:

Stock split is a type of corporate action in which a company replaces its existing shares with more shares at lesser prices. Although this does not affect on the market capitalization of company but an increase in number of shares leads to greater liquidity and greater volume of trades. A stock split is a corporate action that increases the number of corporation's outstanding shares by dividing each share. Stock splits have confounded financial economists for years because they merely increase the number of outstanding shares without providing any new funds to the company and without changing the shareholders' claims on firm's assets. Stock splits remain one of the most popular and least understood phenomena in equity markets.

Stock Split is a US term, which means division of high priced shares into a number of low-priced shares. Therefore, what a company really does in a stock split is that it reduces the face value of the share in a given ratio. It is only an accounting entry and there would be no cash flowing in or out of the company. (Pooja, 2011)

Stock split is a numeric change in the face value of shares that does not affect the investors' equity ownership. In theory, stock splits should not have any effect on share prices and should not create any value as a result. Despite theoretical simplicity, this corporate event has induced different reactions in many capital markets all over the world. Researchers identified many reasons for stock splits such as liquidity, signaling, neglected firm to name a few. (Dr Anjali Gupta, Dr Purushottam Kumar Arya (2020)).

Most of the traders' views those stock splits as high potential trading opportunities. They consider stock splits a positive progression in value and goodwill for companies and their investors. Corporate executives use stock splits as marketing and investor relation tools. They know that stock splits make shareholders feel better and feeling a sense of greater wealth.

2. REVIEW OF LITERATURE:

Pushpender kadian, Monika Yadav (2020) in their resaerch concluded that there is no significance difference between abnormal returns before and after the announcement date so that Indian banking sector is semi-strong form efficient.

SK Md. Imran, B Devisree, K Eswaramma (2019) in their research described that BSE listed companies reaction of stock splits is both positive and negative on the stock split announcement date and concluded that stock splits benefits for both companies and investors.

Shaili Gupta, Dr. B S Bodla (2019) in their paper titled 'An empirical study of stock split announcement and liquidity in Indian stock market' highlighted that stock split announcement does not affect the liquidity of Indian stock market.

Dr.Swapna Sen (2018) in her research explains that split event does not change the value of firm so it is unlikely to create wealth. So there has not been any significant increase in return post-split, rather than quarterly return and abnormal return decline significantly and concluded that stock split as a corporate action is not very acceptable to investors.

Anubha Vashist (2017) in his paper titled 'Stock splits in India', discussed about provisions of SEBI for stock splits, reasons stock splits, limitations of stock splits and major splits in India.

Ruzben Bodhanwala (2016) in his paper titled 'Stock split and reverse split- Evidence from India' highlighted that stock splits are not merely cosmetic event and majority of the shareholders do have a permanent increase in wealth and reverse split do not achieve the same purpose and shareholders lose wealth after reverse split.

Babitha Rohit, Prakash Pinto, Shakila B (2016) in their research concluded that the information content of the two events is impounded in the prices of stock so instantaneously that the investors do not get an opportunity to earn abnormal returns from stock.

Asha Nadig (2015) conducted study to investigate whether investors of BSE stocks gained significantly on account of stock split announcements made by firms. The results shows that significant positive abnormal returns found in prior to split announcements.

Anjali Gupta (2012) in her research explained that there has been no consensus on how markets and share prices around stock splits through in theory splits have no effect on value creation.

Kavitha Chavali, Zaiby Zahid (2011) in their research concluded that stock split should not be the only deciding factor that entices an investor into investing in a stock. There are some strong psychological reasons why companies split their stock; the investors should understand that split does not change any of business fundamentals.

2. OBJECTIVES OF THE STUDY:

Objectives of the study are as follows

1. To study the concept of Stock splits.
2. To analyse various theories relating to stock splits.
3. To know about the reasons for announcement of stock splits.
4. To examine implications of stock splits.

3. RESEARCH METHODOLOGY:

This research is based on the secondary data. Secondary data has been collected from websites, books, articles, journals and magazines related to the topic.

3.1. CONCEPT OF STOCK SPLIT:

A stock split is a decision taken by the company's board of directors to increase the number of outstanding shares by issuing more shares to the present shareholders. For example, in a 2-for-1 stock split, every current shareholder with one share is given an additional share. So, if a company had 10 lakh shares outstanding before the split, it will have 20 lakh shares outstanding after a 2-for-1 split. The stock's price is also affected by a stock split. After a stock split, the stock price will be reduced since the number of outstanding shares has increased. In the example of a 2-for-1 split, the share price will be reduced to half after the split. Although the number of outstanding shares increases and stock prices change, the market capitalization value remains constant.

A stock split is a systematic procedure that increases or decreases a company's total number of outstanding shares without changing the proportionate ownership of existing shareholders. The balance sheet items remain constant except that the total number of outstanding shares of company, they increases proportionately to the ratio of stock split. The most commonly used split ratios are 2:1, 3:1, 4:1, 10:1, etc.

3.2. TYPES OF STOCK SPLITS:

Stock split is dividing into forward split and backward split. The forward split is most beneficial for the existing shareholders. Forward split as a positive reaction of stock exchange companies and comes positive reaction of the companies it also include grater future earnings expectation then the stock split. Forward split as a positive reaction of the stock exchange companies and comes positive results o the companies. It also includes grater future earnings expectation then the stock split. (SK Md. Imran, B Devisree, K Eswaramma (2019)).

There are different types of stock splits that can have different effects based on the reasons they are announced.

- **Literal/Forward stock splits:** a literal stock split will occurs when a company for example announces that it will do a 2-for-1 split of their common stock. If XYZ Company has 10,000 shares of public stock at Rs. 10 per share before a 2:1 split, they will have 20,000 shares of public stock at Rs. 5 per share after.
- **Reverse stock splits:** Reverse stock splits are less common and have a somewhat negative investment strategy adopted by company. If the price of a stock drops too low, there may be a risk of being de-listed and the low stock prices create a psychological stigma as investors view them the stocks as worthless. By doing a reverse stock split decision, companies can increase the stock price by reducing the number of outstanding shares to eliminate the problems caused by the low stock prices.

3.3. THEORIES RELATING TO STOCK SPLITS:

Previous studies show that companies justify stock splits on the basis that they improve liquidity and marketability of the shares. Every year, there are several stock split announcements taking place and most board of directors of companies mentioning the similar reasons as to why they have decided to split their stock.

There are several theories which have attempted to explain the impact of stock splits on share price and trading volume: -

- **Signalling Theory:**
  According to signalling hypothesis, in a scenario of asymmetric information between company and investors, company may use stock split announcements to signal positive information to the market about the firm's future expectations and trends of growth. The signalling theory also states that the investors tend to view a stock split as a positive signal for the firm's future prospects and will tend to purchase these shares, thus creating a rise in the stock price in future.
- **Liquidity Theory:**
  One of the most important theories relating to stocks splits is that to bring positive actions and along with that the investors do not make money from stock splits. An equally prominent theory relating to stock splits is that companies use this strategy to enhance liquidity of stock. The assumption of liquidity enhancement theory is that companies with shares that trade in market close to or more than triple digits become unreachable for many retail investors. As only smaller number investors are participating in the company, the more unnatural liquidity can become, so some companies will plan for stock split to boost liquidity.
- **Optimal Trading Range Theory:**
  According to the optimal trading range hypothesis, stock splits are used as a tool to readjust the share price to a desired price range so that it is more reasonable for the small investors to buy the shares. If a stock prices moves to the upper limit, many times the company's will declare a stock split to bring down the share price to the 'optimal' range. This optimal trading range is largely psychological, as investors with lesser amount of investment funds would prefer to receive more number of shares.
- **Self Serving Management and Dispersion of Control Theory:**
  A conceivable explanation for stock splits claims that a self-serving management prefers a dispersed ownership since small investors cannot exercise greater control over the company and a stock split would likely to achieve this.

4. NEED FOR STOCK SPLITS:

The companies have to take all the troubles and costs to carry out the stock splits. So that the question arises that why companies will announce stock splits? As such, stock splits throughout the world have puzzled researchers who tried to find out possible explanations for such actions and their implications. The previous researchers documented that it is only considered as 'cosmetic decision' took to enhance the value of the firm, as positive abnormal returns are witnessed at the announcement and execution of stock splits

The companies whose share prices increases to the levels that are either too high or beyond the price levels of similar group of companies in the market are usually announce the stock splits. The main intention of stock split is to make shares seem more reasonable to small investors even though the underlying value of the company has not changed. There are various reasons that companies consider while announcing stock splits.

- **Brings the Liquidity of stock** - Another reason for stock split is to bring a stock's liquidity, which increases with the stock's number of outstanding shares.

- **Affordability** - During a bull run in the market, a number of mid-cap and small-cap stocks are chased by retail investors and market operators. Normally, retail investor's pursuit price and not value. The idea of doing a stock split is to make stocks more affordable to retail investors.
- **Improving of Shareholders Base** - Companies also split their stocks if they want to enhance their shareholder base and to make more number of shares available to the investors. This potentially allows a more number of people to own the shares.
- **Psychological Influence on Investors-** one more reason for splitting the stock is psychology. As the price of a stock gets greater, some investors may feel that the price of stocks is too high for them to buy. Stock split brings the share price down to be a more "attractive" level. The effect is purely psychological. Stock split also gives existing shareholders the feeling that they suddenly have more shares than they before and of course, if the prices rise in the market, they have more stock to trade.
- **Performance and Prospects Indicator** – the Companies generally announce split their stock when the company has an optimistic view of its future plans, prospects and operations. The announcement of a stock split can be a signal that the stock has attained a certain level of success.

5. IMPLICATIONS OF STOCK SPLITS:

There are number of arguments over whether a stock split is a beneficial or not to investors. Stock split is considered as a good buying indicator, signalling that the company's share price is increasing and therefore they doing very well. Due to stock split, the high priced stocks will be available at lower rates.

The retail investors can easily afford to purchase stocks of lower price. The major implications of stock splits are as follows

- **Increases outstanding number of shares** – Stock splits increases the outstanding number of shares by reducing face value; it gives the existing shareholders the feeling that they suddenly have more shares than they had before. The current shareholders enjoy the pleasure of multiplying the number of shares.
- **Enhance the liquidity of stock** - The high-priced stock in the market leads to be illiquid due to psychological reasons of investors and transaction costs involved. So that, when the price of stock raises up to a high level, the management will split the stock to reduce the price of stock to support trading which attracts the investors to buy and helps companies to enhance the liquidity.
- **Indicator of company growth and prospects-** Stock split is considered as a positive indicator of company growth and prospects. The Companies which are announcing stock splits have typically enjoyed a drastic change in share prices.
- **Increases the affordability of Each Share** – stock splits reduce the share price to an attractive level. Commonly, a company is also motivated to split their stock to attract more number of investors with a lower share price. Hence stock splits bring the affordability of each share.

6. CONSEQUENCES OF STOCK SPLITS:

- **Easy to buy and sell** – Stock splits leads to reduce the price of stocks it affects psychologically on investors they feels that it is very easier to buy and sell comparably to the higher prices. Once share prices drop after a stock split, it leads to more impulsive selling.
- **Risks of low price** – Generally the companies whose stock price are too high they are going to split their stocks to attract more investors but it becomes an less attractive for large and institutional investors hence there may be a chance of company loses demand for its shares in the market this may be going to effect on share prices.
- **Problem of de-listing**: Each and every listed company in a stock exchange must maintain a certain minimum price per share, if a company announces the stock splits definitely reduces the price of shares and value of the company then there is a chance of shares may fall below the listing requirement due to that it may be delisted from stock exchange.
- **Costly decision** – Company have to incur various costs and is not free for the company. Company have to call upon meeting of board of directors or shareholders to take a decision. Company have to announce the date and effects of splits by following listing exchange and legal requirements. Written notification of letters and mailing them out to all shareholders gets costly for companies.
- **Challenge of maintenance of records** – After the announcement of stock splits, it will be more challengeable for company accountants, shareholders and analysts to create and maintain records. Once the company announces the stock splits, it reduces the share price and it will become difficult to assess the value of company

stock. But fortunately the advanced software tools make it easier for companies and investors to show split adjustments.

7. STOCK SPLITS IN INDIA:

There are many companies that have announced or will soon be announcing stock splits. There are several reasons that companies split their stocks aside from having appreciated to new highs. Sometimes a company must announce a stock split in order to meet the exchange's listing requirements that oblige them to have a certain number of shares outstanding. Stock splits in India have grown since the beginning of 21st century due to upward rise in the Indian stock markets. Maximizing shareholder's wealth has been a driving force for all corporate actions because of which many of the companies have found it appropriate to go for stock splits. Stock split has been seen to react differently through various phases of the split life cycle. It is believed that stock split announcements is a signal of the management's optimism about the company's future earnings. At the same time it is believed that the firms use the positive reaction to the split announcement to raise more funds at a higher price after the split. (Keerthana reddy SR, Prof. Nijumon K John (2013))

Table-1: Year wise details of stock splits in India

YEAR	NO OF INDIAN COMPANIES ANNOUNCED STOCK SPLITS
2001	23
2002	33
2003	29
2004	32
2005	144
2006	83
2007	75
2008	84
2009	72
2010	121
2011	81
2012	59
2013	70
2014	82
2015	91
2016	76
2017	72
2018	56
2019	35
2020	30
2021(Up to 31-07-2021)	32
TOTAL	**1380**

Source: http://www.moneycontrol.com

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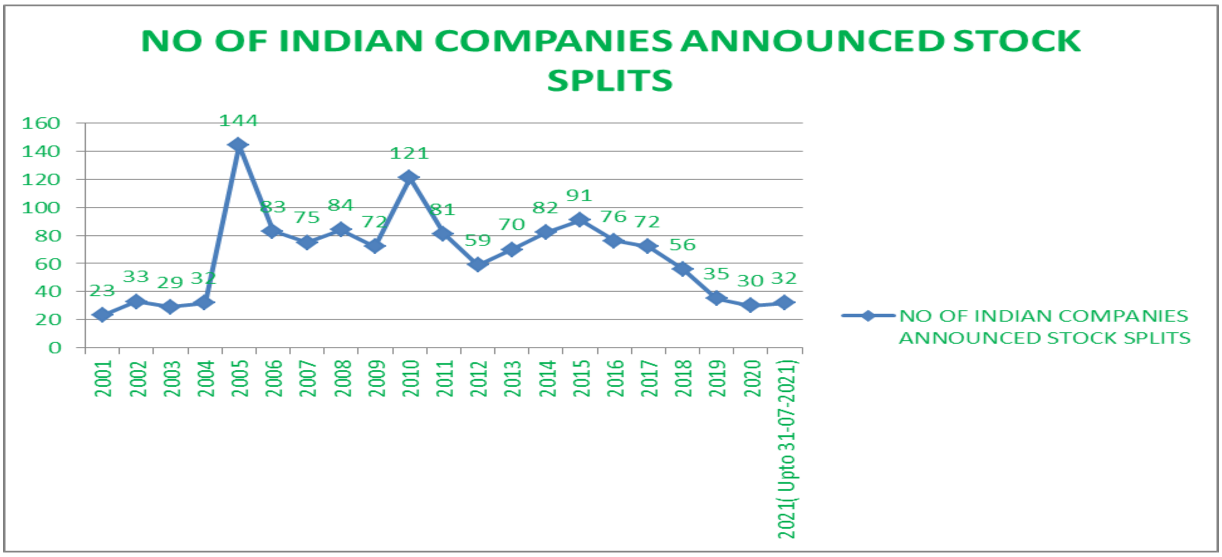
Figure-1: Year wise details of stock splits in India



Descriptive statistics

Mean	65.71428571
Standard Error	6.921375743
Median	72
Mode	32
Standard Deviation	31.71772826
Sample Variance	1006.014286
Kurtosis	0.432978496
Skewness	0.64383409
Range	121
Minimum	23
Maximum	144
Sum	1380
Count	21

It is observed from the above table and figure is that from 2001 to 2021 (up to 31-07-2021) total 1380 Indian companies announced the stock splits and more number of stock splits announced in the year 2005 (144companies) and followed by 2010(121 companies) because in the early 2005 and middle of 2010 with the bull phase in Indian stock markets, the stock prices of many companies shooting far beyond the normal trading range so that to make their stocks optimal trading range many companies took an decision of split their stocks. By observing the above table it is clear that in an average every year 65 Indian companies are announcing stock splits and the trend of announcement of splits fluctuating and after the 2015 trend moving downwards.

8. FINDINGS OF THE STUDY:

Findings of the empirical study on stock splits are as follows

- A stock split increases the outstanding number of shares by reducing face value.
- Stock split decision taken to create impact on market based on some theories like signalling, liquidity, optimal trading range, etc..,
- Stock splits needed to bring liquidity of stock, to improve shareholders base, to influence psychologically on investors and to make stocks more affordable to retail investors.
- Generally the companies whose stock prices are too high they are going to split their stocks to attract more investors.

9. CONCLUSION:

Stock split is a corporate action in which company divides the existing shares into multiple new shares to boost the liquidity of stock in market. Even though the number of shares outstanding increases and doesn't add any real value, hence the total value of stock remains the same compare to pre-stock split amount. Stock splits are usually done when the stock price of a firm has raised so high or beyond the price levels of similar companies in the sector that it becomes an impediment to new and retail investors. Splitting of stock boost up liquidity in the market and is a positive signal to the investors about company growth and prospects. Announcement stock splits results that increases outstanding number of shares by enhancing shareholders base and makes shares more affordable to investors and also influence physiologically.

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