Chapter-1

Introduction
INTRODUCTION

1.1 Background of the Study

1.1.1 An Introduction to Indian Stock Market

The Indian stock market in the present day is in point of fact encompasses two foremost units and over twenty additional exchanges. These two principal units are the Bombay Stock Exchange (BSE) and the National Stock Exchange of India (NSE). There is a remarkable history record as regards where the two markets started off from. The earliest record dates back to 1850’s, when the first stock exchange was set up in the country whilst the East India Company formed and built up a society of brokers. Further, by 1860, there were already sixty broker members of the exchange. Besides by the time of 1874 and the domino effect of a fast increasing share trading industry, these brokers grouped on a regular basis, at a well-known location which is currently known as Dalal Street for undertaking their trade. Stockbrokers started crowding in front of Mumbai’s Town Hall, carrying there get-together beneath Banyan trees, and in this way the Indian stock market came into being (Lawton, 2010).

Even though there are in fact over twenty diverse stock exchanges in India these days, yet the two most prevailing ones are the two NSE and BSE. BSE in fact was at first set up in 1875; it is worth mentioning here that BSE is the oldest stock market of the whole Asian continent that has been undertaking the trade ever since the very commencement. In the present day there are more than 4,700 firms listed on the BSE with that of over 7,700 stock exchange scripts. On the other hand, NSE is an Indian stock market based in the commercial capital of India Mumbai and was initially set up just eighteen years ago in 1992. However, remarkably in very short phase of time, NSE has grown-up to
almost 1,600 firm listings. The upbeat point of NSE is that it has the capacity to emerge the largest stock exchange in India (Lawton, 2010).

Until the time of 1980, truly there was no method to quantify or scale the variations in share value or stock prices. It was in 1986 that the BSE put into practice SENSEX as scale of measuring a stock index or stock price. Further in 1989, India witnessed the opening of the BSE National Index, and it was renamed the BSE-100 Index in October of 1996 for the reason that it was consisted of 100 diverse stocks listed with India's five foremost stock exchanges. These five leading markets were Ahmedabad, Calcutta, Delhi, Madras, and Mumbai. In addition, the dollar-linked side of the BSE-100 was started in 2006 (Lawton, 2010). Today several banking organizations, financial intermediaries, insurance firms, and foremost financial institutions jointly have possession of the NSE. Nonetheless, the units of management and possession are entirely broken up units. The current status of grown-up Indian stock market is the result of gradual development for a long period since the time of East India Company rule in the country. At present Indian stock market is globally recognized and the largest in Asia, nevertheless, the Indian stock has to travel a long way comparing the stock market of developed world.

At the moment all in all there are just 22 stock exchanges in Indian stock market, apart from additional stock exchanges in the forms of Calcutta, Bangalore, Chennai, Ahmedabad, Delhi, stock exchanges. The stock market in India as well has a NSE located in Mumbai, and further the stock market in the country encompasses an Over the Counter Exchange of India (OTCEI) where the listings of the medium sized and small sized firms are undertaken. There is a regulatory unit of Indian stock market named the Securities and Exchange Board of India (SEBI), which is a dictatorial body
supervising the functioning of the stock exchanges in India (Lawton, 2010). The Indian stock market such as other stock markets in various countries of the world make available for the buy and sell of equity shares, and supplies relating to public firms in India with that of the world. The shares in point of fact make available information regarding the performance of the firm, where elevated the share price or value implies that the firm is creating return.

The Stock Market in India is a vital division of the countries economy and the index for the development of the economy. Moreover, the Indian stock market works as a raised area for infrastructural growth and development plans of the fresh or newly established firms. The firms might move up funds all the way through the giving out of their equity shares to the public, where intelligibility is an extremely vital factor for a firm to conduct buy and sell of the equity in the stock market. The foremost basics of the firm which may perhaps control the investors are profits, debts, revenues, possessions, infrastructure, etc and the firm may have to be extremely see-through as regards these aspects.

By way of the mechanization and liberalization of the Indian stock markets, there had been a noticeable alteration in the Indian Stock market in the phase of post-liberalisation and particularly in the phase of 1990s. Operating system in BSE and NSE has accomplished an international standard and has formed a countrywide trading structure that offers equal access to each and every one investor not considering physical locality. In this regard, the contribution of technology has been immense in relation to bringing about fairness amongst the investors in whatsoever part of the country. In fact, Indian stock market has introduced the most excellent probable methods applied in developed or in advanced stock markets such as electronic trading
classification, rolling settlement in place of the account period settlement, add to trading hour, dematerialization of shares and opening of derivates etc. Worth to mention here that the spotlight on the peripheral segment has encouraged several Indian firms, particularly those in the quarter of information technology, to list at the most developed and advanced stock exchanges in US.

Through the opening of highly developed practices, intelligibility has as well augmented in the Indian stock market. Additionally, in the midst of the momentous dealings of opening up of capital market, portfolio deal by foreign institutional investors in the forms of pension funds, mutual funds, investment trusts, asset management firms have created revolution in the Indian stock markets. With the introduction of reforms in the financial sector of the country’s economy started in 1991, not just foreign institutional investment and non-resident Indians are permitted to put money in Indian stock markets, but as well Indian corporates have been permitted to knock the worldwide market in the forms of global depository receipts, American depository receipts and foreign currency convertible bonds. The entire of these alterations have directed to considerable development in market capitalization, liquidity and good organization and first-rate proficiency of the Indian stock market (Ahmad and Ahmed, 2005).

There has had been unprecedented growth and advancement in Indian stock market considering the deregulation and market liberalization actions and the growing movements of multinational firms. Therefore, specified the spanning interest in the Indian stock markets for the duration of liberalization era, it is interesting to be acquainted with the assimilation of Indian stock markets. The fiscal markets, more than ever the stock markets, for developing and developed markets have currently developed
into more and more incorporated in spite of the distinctiveness of the explicit market and country silhouette. This has had occurred specially because of liberalization in financial sector taken on by the majority of the countries all over the world, technological progression in communications and trading systems, opening of pioneering financial products and generating additional opportunities for international portfolio investments. This has stepped up the inquisitiveness for investigating worldwide market relations with Indian stock market (Ahmad and Ahmed, 2005).

Certainly the growth of Indian stock market has been remarkable, though its integration with global stock markets is yet to be truly realized. In spite of this, Indian stock market in itself presents an example of grown up stock market, but the regretting part is that Indian stock market is comparatively very little investigated. Whatever investigations have been conducted are old and do not appear pertinent considering the current position of Indian stock market integrated with global markets in the forms foreign institutional investments, American depository receipts and foreign currency convertible bonds and others. This research attempts to fill this gap in the literature.

In comparison to old and new emerging stock markets in Asia, the Indian stock market has had been documented as comparatively not as much of responsive to variations of Asian and developed and advanced stock markets of the world. As a result, despite the fact that Indian stock market has leading figure of listed firms, it has received slight notice whilst carrying out studies as regards interconnectedness of global stock markets. Researchers have hardly ever incorporated the Indian Stock Market whilst examining the control of the developed stock markets on Asian stock markets and interdependence amongst Asian stock markets (Rajesh, 2010). These researches are confirmations that Indian stock market has not just received comparatively not as much
of notice of researchers and practitioners in the turf of global finance but as well the
market is regarded to be rather inaccessible for global markets. Despite this, a number
of concepts as regards trading have come into Indian stock market from the global
markets and bonus share is one of that concept. This research is focused to investigate
the relationship of bonus share and equity price behaviour in Indian stock market.

1.1.2 Relationship between equity share and bonus share

The word bonus implies added share rewarded to shareholders in a firm from extra
earning. It is open shares of stock offered to current shareholders in a firm, in relation
to the figure of shares the shareholder by now have possession of by the occasion of
declaration of bonus (Amuthan and Ayyappan, 2011). More clearly, bonus shares are
issued by a firm in the case it proposes to disburse extra earning by issuing shares.
Bonus shares are stated as soon as firm has enough earnings to announce bonus but
either does not have cash to disburse it or does not desire to part with it for executing
various capital spending procedure. In consequence, bonus shares result in the
capitalization of earnings of the firm.

Bonus issues are just giving out of added stocks to the current shareholders, and it is an
open issue of shares, devoid of a contribution price, made to current shareholders in
ratio to their present deal. A firm might share out bonus shares by means of using saved
earnings or accrued capital assets. The point of consideration is that in all probability, a
firm will create a bonus issue just if it is sensibly definite that the upcoming cash flows
will be bulky enough to hold up an increase in the cash bonus payments. Nonetheless, it
might so come about that the upcoming cash flows are not sufficient and for this reason
the firms may be compelled to decrease the bonus rate that results in a lessening of cash
earnings in comparison with the cash earning prior to the bonus issue (Amuthan and
Logically, this is an area of immense concern for both researchers and practitioners in the field of Indian stock market. Therefore studies require to be conducted to investigate how the equity share earnings of the firms behave subsequent to issuing the bonus share. From the research literature it comes out that in some case there is strong relationship between equity share and bonus share whereas in several cases there is no such well-built relationship.

The association stuck between bonus issues and share prices has had been the topic of a great deal empirical investigation in research literature related to the field of finance. Empirical research conducted with the case of advanced or developed stock markets such as US has demonstrated that the market normally responds optimistically to the declaration of a bonus issue. The proposition that has obtained strongest hold up in elucidating the encouraging market response to bonus issue declarations is the hinting proposition, which puts forward that the declaration of a bonus issue communicates fresh information as regards the market in cases where managers have asymmetric information. This proposition has obtained just about unambiguous hold up with few exceptions. In accordance with the extended proposition, the announcements of bonus issues put across positive private information in relation to the future earnings to the investors, where managers have better information regarding the future earnings, for the reason that there might be asymmetric information involving managers and investors. These studies are related to the declaration time of bonus issue and its effect and direct to carry out the research that what will be the relationship between bonus shares and equity price behaviour of firms listed on the stock market. For conducting the research, the research process follows basically two courses of action. In the former case, the literature is reviewed as regards the research topic and in the later case the
data collected is analyzed using different analytical models. In this section of the paper the results of studies are critically discussed as regards the relationship between equity share and bonus share.

Old but one of the remarkable study investigating the relationship between equity share and bonus share is that of McNichols and Dravid (1990), and their study presents the facts to hold up the proposition that there is a positive relationship between the bonus share in the form of size of a stock dividend and the scale of atypical returns in the order of the declaration time. The results of their study confirm a positive relationship between bonus share and atypical return implying that the bigger the bonus share price, the better the obtained earnings. Nevertheless, a study conducted by Papaioannou et al. (2000) in the case of US investigates price response to bonus share price declarations by firms listed on the Athens Stock Exchange revealing no statistically significant atypical earnings on and around the declaration time. The results of this study might be elucidated by the detail that most stock dividend giving out or issuing bonus share has nothing to do with equity share and that issuing of bonus share is just compliance of fulfilling obligatory necessities forced upon the firms to gratify regulatory necessities and shareholder endorsement ought to be sought as regards the dimension and conditions of the distributions. Moreover, Ho et. al. (2002) have investigated in their study that whether there is any liquidity change flanked by the pre issue period and the post issue period of Seasoned Equity offerings making use of data from Taiwan market. The results of the study reveal that there is a statistically momentous boost in liquidity (in relation to quantity of shares traded divided by quantity of shares outstanding, while firms create seasoned equity offerings. In addition, the liquidity enrichment comes out to put up with no momentous relationship with the issuing range, the issuing price, and
the market value of the firm that issues the bonus share. On the other hand, Balachandran et. al. (2004) have conducted a study investigating share price response of the declaration of bonus share issues in relation to the case of Australian firms for the duration of 1992 to 2000. Their study reveal that bonus issue declaration directs to a statistically significant affirmative price response, and further the study offers confirmation holding up the proposition reliable with the results obtained from the US, Sweden, Canada and New Zealand. Nevertheless, an exceptional result of this study is that the relationship between bonus share and equity share is stronger for industrial non-financial and mining firms than the firms operating in financial sector.

As far as the case of Indian stock market is concerned, the research literature presents some old and new studies examining the relationship between bonus share and equity share. In this context, the first and foremost study was conducted by Ramachandran (1985), and this study investigates the effect of declaration of bonus issues on equity stock prices and comes out with assorted confirmation for semi well-built form competence of stock market in India. In another remarkable study Rao and Geetha (1996) investigates bonus declarations and comes to the conclusion that one may perhaps not create surplus funds in the stock market through learning that prototypes of atypical returns of declarations created previously. Moreover, Rao (1994) comes out with the evidences of encouraging stock market response to equity bonus declaration, estimating cumulative atypical return of 6.31 percent just about the three days of bonus declaration. Besides Mohanty (1999) comes out with the results that the majority of the firms either maintaining the matching bonus rate after the bonus imbursement or reducing it less than proportionately, subsequent to taking into account bonus imbursement and in that way boosts the cash flows to the shareholders. Furthermore,
Mishra (2003) reveal a positive cumulative atypical return just about the bonus issue declaration. More importantly, Obaidullah and Srinivasan (2002) reveal tremendously big positive atypical profits on ex-bonus and ex-rights time for equity stocks. Comparable study by Budhraja et al. (2004) taking the data of BSE comes out with the results that atypical returns in stock prices just about the bonus declaration time over a three day trading phase opening one day prior to the declaration time is significant at 95 percent buoyancy maximum value. The results too state that a great deal of the information as regards the bonus declaration gets confiscates into stocks by the time of declaration. Share price or value volatility in Indian firms or organizations appear to be controlled more by rather internal factors than external factors. Specifically there comes out to be no twist of fate stuck between unpredictability of portfolio capital flows in and out of the stock market and the unpredictability budges in share price valuation of Indian firms. The results of this study as well state that share value variation of Indian firms has not heaped on following liberalization of financial sector.

Despite the bulk of studies obtainable the research literature in relations to the relationship between bonus share and equity share, it can be easily found that not much endeavor has been made to investigate the liquidity change just about bonus issue declaration and effect on equity price. This is for the reason that on the one hand, studies are less linked to emerging stock markets such as India and the studies are not fresh or up-to-the minute. Also that the varied evidences presented by the studies make the occurrence confusing rather than clearing. For the case of emerging markets like India the obtainable literature do not make available any apparent substantiation of the effect. Despite the fact that the majority of the studies have investigated the variations in atypical returns and collective atypical returns, and even a few of these studies that
have been discussed above pulls out the literature to discover whether the volume of the bonus issue, the market value of firm and the pre cumulative atypical returns add to the atypical returns pragmatic around bonus issue declaration. The issuing of bonus shares being a well-liked and recurrently utilized apparatus for performance of the firms; it is significant to know the effect of such issues on the stock market both in relation to alteration in earnings and alteration in liquidity in an emerging stock market such as that of Indian stock market. This is what in this study an attempt is made to investigate the stock market response just about bonus issue declaration in relation to equity share with reference to alterations in cumulative atypical earnings and alterations in liquidity and further an endeavor is made to make out the significant factors that would have enabled alterations in cumulative atypical returns. This study is conducted considering the proposition that the response of bonus issue declaration could diverge as per the scenery of a specific industry, the study is carried out with definite case to bonus issue declaration. This is based on the rationale that firms necessitate to think about the under response of the stock market in the form of equity value subsequent to the bonus share issuing. Moreover, the results of this study may well assist the people who take policy decisions as regards financial sector to judge the result of their bonus decisions in relation to the firms' success and prosperity.

1.2 Problem Statement

The theoretical premise linked to finance reflects on a bonus issue as a financial delusion for the reason that it does not add value to the firm in the symmetric information postulation. The practitioner in the area only makes a book entry by means of debiting a few open reserves account and recognizing the share capital account, but does not in a straight line involve any cash inflow or outflow and, consequently, it is
supposed that it does not add value to the firm (Chandra, 2000). This implies that if a firm gives out an acknowledged portion of its earnings every year as dividend, in that case the bonus issue will bring down the dividend in percentage to the bonus ratio and that's why the speculative ex-bonus share price will go down in percentage to the bonus fraction. On the other hand, the numeral of shares the firm holds goes up in the similar percentage and for this reason the shareholders' value carries on unaffected. If, nevertheless, management has improved information as regards the future prospects of a firm than the shareholders, in that case a bonus issue might put across a few value pertinent information to the shareholders. The shareholders supposedly might reflect that the management is more convinced of the future and consequently the cash flows because of dividends will boost after the bonus issue and in that case the bonus issue will be hailed by the shareholders.

So far as the case of India is concerned, the disbursement proportion does not come out to concern much as it is the share value and not the disbursement proportion that is significant to explicate the dividend paying behaviour of the firms, as there is the inappropriateness of the disbursement proportion in the Indian circumstance, and therefore it is in this very context that the bonus issue by a firm turns out to be imperative. The shareholders do not anticipate the dividend price to go down proportionately once issuing the bonus share. Consequently, the cash flow to the shareholder is projected to go up once the bonus share is issued. The ex-bonus share price would consequently be a lesser amount of the conjectural ex-bonus price (Amuthan and Ayyappan, 2011). As a result, the shareholders suppose the bonus issuing firms to create more returns than the non-bonus paying firm. On the other hand, it might be flawlessly promising to assume of circumstances where the firm, once
issuing a bonus share, is not proficient to uphold the dividend rate due to cash flow harms. At this point, the hopes of the shareholders crushed down and, consequently, the share prices lean to go down. It is in this context that the issue of relationship between bonus share and equity share or share value takes significance.

In the previous section, some studies have been mentioned that presents the contradictory results in relation to the effect of bonus share on equity share or share price. Most of the studies in this context have been in the background of developed markets; nevertheless, there are some studies in Indian context too presenting the contradictory results. Mishra (2003) reveal a positive cumulative atypical return just about the bonus issue declaration. More importantly, Obaidullah and Srinivasan (2002) reveal tremendously big positive atypical profits on ex-bonus and ex-rights time for equity stocks. Comparable study by Budhraja et al. (2004) taking the data of BSE comes out with the results that atypical returns in stock prices just about the bonus declaration time over a three day trading phase opening one day prior to the declaration time is significant at 95 percent buoyancy maximum value. The results too state that a great deal of the information as regards the bonus declaration gets confiscates into stocks by the time of declaration. On the one hand, studies are less linked to emerging stock markets such as India and the studies are not fresh or up-to-the minute. Also that the varied evidences presented by the studies make the occurrence confusing rather than clearing. For the case emerging markets like India the obtainable literature do not make available any apparent substantiation of the effect. In this background a number of questions come to our mind. Whether there is any effect of bonus share issue on equity share price behaviour, either in log-term or short-term? What is the relationship between bonus share and equity share price? What is the movement of share price prior
and after of declaring bonus share issue? What is the impact of bonus share on firm and its stakeholder’s earnings? Whether shareholder value increases in the case of issuing bonus share? These are the issues that are investigated in this study with reference to Indian context.

1.3 Aims and Objectives of the Study

This study aims to investigate the relationship of bonus shares and equity share price behaviour in India. Equity share is the share which is commonplace in the course of firm’s business and is too termed as ordinary share. On the other hand, bonus share is a share issued by cashing in on the free funds as regards collected earnings of the firm. The study is conducted with reference firms’ bonus share and equity price behaviour in various Indian industries.

Following are the Research Objectives :-

1. To Study the relationship between the Bonus share issue and the share price behavior in India.

2. To Study how do prices moves before and after Bonus announcement.

3. To Study about the effect of Bonus share issue on equity share behavior in short run and long run.

4. To Study about the volume of shares traded before and after the announcement of bonus shares in selected Indian industries.

5. To highlight the impact of Bonus shares on firm and its stake holders
1.4 Significance of the Study

There is an indiscriminate lessening in Indian stock market shakiness when it comes to reform led post liberalization period. Commonly, in the post liberalization phase in India, the bull periods are longer, the amplitude of bull periods is elevated and the unpredictability in bull periods is as well elevated than in the bear periods. Comparing to its pre liberalization temperament, nevertheless, the bull periods are more unwavering in the post liberalization phase. The growth of Indian stock market has been remarkable in post-liberalization period, though its integration with global stock markets is yet to be truly realized. In spite of this, Indian stock market in itself presents an example of grown up stock market, but the regretting part is that Indian stock market is comparatively very little investigated. Indian stock market has not just received comparatively as much of notice of researchers and practitioners in the turf of global finance but as well the market is regarded to be rather inaccessible for global markets. Despite this, a number of concepts as regard trading have come into Indian stock market from the global markets and bonus share is one of that concept. This research is focused to investigate the relationship of bonus share and equity price behaviour in Indian stock market. The issuing of bonus shares being a well-liked and recurrently utilized apparatus to pointer performance of the firms; it is significant to know the effect of such issues on the stock market both in relation to alteration in earnings and alteration in liquidity in an emerging stock market such as that of Indian stock market. This study is conducted considering the proposition that the response of bonus issue declaration could diverge as per the scenery of a specific industry, the study is carried out with definite case to bonus issue declaration. This is based on the rationale that firms necessitate to think about the under response of the stock market in the form of equity value subsequent to the bonus share issuing.
Despite the bulk of studies obtainable the research literature in relations to the relationship between bonus share and equity share, it can be easily found that not much endeavor has been made to investigate the liquidity change just about bonus issue declaration and effect on equity price. This is for the reason that on the one hand, studies are less linked to emerging stock markets such as India and the studies are not fresh or up-to-the-minute. Also that the varied evidences presented by the studies make the occurrence confusing rather than clearing. For the case emerging markets like India the obtainable literature do not make available any apparent substantiation of the effect. Regardless of the fact that the majority of the studies have investigated the variations in atypical returns and collective atypical returns, and even a few of these studies that have been discussed above pulls out the literature to discover whether the volume of the bonus issue, the market value of firm and the pre cumulative atypical returns add to the atypical returns pragmatic around bonus issue declaration. The issuing of bonus shares being a well-liked and recurrently utilized apparatus to pointer performance of the firms; it is significant to know the effect of such issues on the stock market both in relation to alteration in earnings and alteration in liquidity in an emerging stock market such as that of Indian stock market.

The studies reveal that share price or value volatility in Indian firms or organizations appear to be controlled more by rather internal factors than external factors. Specifically there comes out to be no twist of fate stuck between unpredictability of portfolio capital flows in and out of the stock market and the unpredictability budge in share price valuation of Indian firms. The results of this study as well state that share value variation of Indian firms has not heaped on following liberalization of financial sector. In general, the results of the studies conclude that Indian stock market is in its
emerging phase through the volatility or improbability in share value of Indian firms is not as high as the cases of firms in other emerging stock markets. Even in the post-liberalization period, with a few exceptions the variations in share of Indian firms collectively have not been as high as predicted by the researchers and practitioners. Therefore, there is found standard or modest variations in share value or price of Indian firms or business organizations.

It is in context that this study an attempt is made to investigate the stock market response just about bonus issue declaration in relation to equity share with reference to alterations in cumulative atypical earnings and alterations in liquidity and further an endeavor is made to make out the significant factors that would have enabled alterations in cumulative atypical returns. This study is conducted considering the proposition that the response of bonus issue declaration could diverge as per the scenery of a specific industry, the study is carried out with definite case to bonus issue declaration. This is based on the rationale that firms necessitate to think about the under response of the stock market in the form of equity value subsequent to the bonus share issuing. Moreover, the results of this study may well assist the people who take policy decisions as regards financial sector to judge the result of their bonus decisions in relation to the firms’ success and prosperity.

1.5 Organization of the Thesis

The following is an overview of the contents of each chapter present in this thesis

i. Chapter 1 is the introduction chapter that gives a basic idea from this the research concept has emerged.
ii. Chapter 2 is the review of literature chapter that explores several works related to bonus and equity shares, their valuation and distribution that are already in existence.

iii. Chapter 3 is the research methodology chapter that gives an overview of research design, strategy, sampling design, sampling plan, data types, data analysis and interpretation techniques used in this study.

iv. Chapter 4 is the data analysis and interpretation chapter that presents the analysis of the collected secondary data.

v. Chapter 5 is the conclusion chapter that summarizes the findings obtained in data analysis section along with conclusion of the study followed by strategies for improvement and recommendations for future research.

Besides, this research thesis has a bibliography section containing the sources that were used in conducting the research followed by an appendix section that has tools like balance sheets, financial ratios and cash flow statements that were used in conducting the research.