CORPORATE ACTIONS AND IMPACT ON STOCK MARKETS PRICES – AN EMPIRICAL STUDY OF INDIAN MARKETS

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Introduction
Corporate actions are those actions taken by the management team of a corporate entity. One of the cardinal principles of a Corporate Management is to enhance the shareholder value. Corporate actions are a part of value enhancing exercise undertaken by the management. These corporate actions may or may not require further action on the part of investors. Corporate actions could be in the form of Dividend, Rights entitlement, Bonus, Mergers, Stock split, consolidation etc.

When a publicly-traded company issues a corporate action, it is initiating a process that will bring changes to its stock. Corporate actions attract the attention of Investors since the undertaken corporate action indicates a change in the company's financial affairs.

There is a belief among investors that market prices are affected by corporate actions because of this attention.

Stock Splits
As the name implies, a stock split divides each of the outstanding shares of a company, thereby lowering the price per share - the market will adjust the price on the day the action is implemented. A stock split, however, is a non-event, meaning that it does not affect a company's equity, or its market capitalization. Only the number of shares outstanding change, so a stock split does not directly change the value or net assets of a company.

For instance, a company announcing a stock split from say Rs.10/- face value to Rs.2/- face value, will have an additional 5 shares for every one share, so the total shares outstanding will be five times but with reduced face value. At the same time, because the value of the company and its shares did not change, the price per share will drop by one fifth.
A company plans to split its stock only for the purpose of enhancing liquidity thus enabling more trades in the stock markets. Before stock split the price could be higher and many investors may not be able to afford the price quoted by the market. After the split, the prices becomes more affordable for the common investor and hence there could be more trading in the particular share.

Consolidation
A consolidation is the reverse of split. In this, a company that would like to increase the price of its shares. For instance, a company whose shares have a face value of Rs.2/- presently may consolidate its shares to have a face value of Rs.10/-. In this case, the number of shares outstanding will be reduced by one fifth and retaining the same market capitalization. Except the change in the number of shares, there is no other financial change.
One of the motives for consolidation could be that the company wants to shed its status as a penny stock. Generally, penny stocks are not preferred by institutional investors. A company’s image is enhanced when there are more institutional investors. Other times companies may use a reverse split to drive out small investors.

**Share Buy Back**
Share buy back is an exercise in which the company purchases the shares from its investors and extinguishes the shares. This results in the number of shares getting reduced. Consequently, even with the same earnings, a higher EPS is reported. This leads to re-rating the valuations of the share and subsequently raises the share prices.

For instance, if a company presently has 1000 shares in its capital and its net earnings are Rs.10000, its EPS is Rs.10/- . If the company goes for a share buyback of say 200 shares, the number of shares is now only 800. With the same Rs.10000/- net earnings, its EPS increases to 12.5.

There are strict laws in place for the company to make share buy back operational

There are several other corporate actions like Rights Issue, Bonus Issue, Dividend etc.

**Literature Review**
Garcia de Andoin and Bacon (2009)\(^1\) had studied the impact of stock split announcement on the stock prices of companies listed in NASDAQ. Their study had concluded that “firms’ public stock split announcements did not affect stock price on the announcement day. Rather, for the two for one and three for two forward split samples, stock price exhibited a significant positive reaction up to 27 days prior to the announcement. For the reverse split sample, stock price exhibited a significant negative reaction up to 30 days prior to the announcement.” They had also opined that “Investors greet forward stock split announcement with a positive sign, whereas they view reverse splits as bad news. Management may be using stock splits to adjust stock price to a more marketable range, downward with forwar and upward for reverse splits”

Pavabutr and Sirodom (2008)\(^2\) had studied the impact of price and liquidity on the stock exchange of Thailand. Their study “finds evidence that stock splits can have favorable impact on stock price through reduction of trade frictions such as bid-ask spreads and price impact measures. The reduction in bid-ask spread and price impact is a consequence of increased trading frequency of market participants who are expected to have a preferred trading range”.

**Methodology**
This paper examines the impact Stock split, Consolidation and Share buy back on the sample companies.

A total of nine companies listed on the Bombay Stock Exchange have been randomly selected for the purpose of the study with 3 companies each for stock split, consolidation and share buy back.
Table 1 Details of companies selected for the study

<table>
<thead>
<tr>
<th>Name of the company</th>
<th>Corporate Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tata Global Beverages Ltd</td>
<td>Stock Split</td>
</tr>
<tr>
<td>20 Microns Ltd</td>
<td>Stock Split</td>
</tr>
<tr>
<td>Asian Paints Ltd</td>
<td>Stock Split</td>
</tr>
<tr>
<td>Akzo Nobel India Ltd</td>
<td>Buy Back of shares</td>
</tr>
<tr>
<td>Mastek Ltd</td>
<td>Buy Back of Shares</td>
</tr>
<tr>
<td>Kanoria Chemicals Industries Ltd</td>
<td>Buy Back of Shares</td>
</tr>
<tr>
<td>Resurgere Mines Minerals India Ltd</td>
<td>Consolidation of Shares</td>
</tr>
<tr>
<td>Nissan Copper Limited</td>
<td>Consolidation of Shares</td>
</tr>
<tr>
<td>Arvind Remedies Limited</td>
<td>Consolidation of Shares</td>
</tr>
</tbody>
</table>

This study considers the date of intimation of the corporate action by the company to the Bombay Stock Exchange as the cut off date. The behaviour of the stock for a period of 90 days before intimation to the stock exchange and 90 days after intimation has been studied.

For the purpose of the study, the volume of trading has been considered. Market prices could have been considered, but the prices are influenced by several other factors other than corporate action. Trading volumes are technical indicators about the momentum in a particular counter. As already mentioned above, corporate actions attract the attention of the investors. If there is interest in the stock because of corporate actions, then volumes are bound to increase. Based on this logic, traded volumes have been selected as a criteria.

The required data for the study has been obtained from the official website of the Bombay Stock Exchange, www.bseindia.com

Three hypothesis have been formed one each for Stock split, share buyback and consolidation.

The research has been designed to test the above hypothesis by “calculating the sample means and using the difference in the two sample means to test the difference in the two population means”\(^3\). The \(z\) score has been computed using the formula:

\[
z = \frac{(\bar{X}_1 - \bar{X}_2) - (\mu_1 - \mu_2)}{\sqrt{\frac{\sigma^2_1}{n_1} + \frac{\sigma^2_2}{n_2}}}
\]

This research involves comparing two samples and testing whether there is a difference in the average volumes. Hence it is a two tailed test. The computed \(Z\) score is tested at 99% confidence level. Therefore, each of the two rejection regions has an area of 0.005 leaving 0.495 of the area in the distribution between each critical value and the mean of the distribution. When the computed \(Z\) score is less than the critical value obtained from the \(z\) table, the null hypothesis is accepted. In statistics, as a convention, when the calculated value is less than the tabled value, we do not say that the null hypothesis should be accepted but simply say that there is no reason to reject the null hypothesis.
Hypothesis

First Hypothesis:  
H₀: There is no impact of split on the volumes of shares traded before and after stock split.  
H₁: There is an impact of split on the volumes of shares traded before and after stock split

Second Hypothesis  
H₀: There is no impact of consolidation on the volumes of shares traded before and after Consolidation  
H₁: There is an impact of consolidation on the volumes of shares traded before and after Consolidation

Third Hypothesis  
H₀: There is no impact of Share buyback on the volumes of shares traded before and after the buy back decision  
H₁: There is impact of Share buyback on the volumes of shares traded before and after the buy back decision

Data Analysis and Discussion of results

The results of the computation are given in Table 2.

Table 2  

<table>
<thead>
<tr>
<th>Corporate Action</th>
<th>Company</th>
<th>z Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Split</td>
<td>Tata Global Beverages</td>
<td>4.2</td>
</tr>
<tr>
<td>Stock Split</td>
<td>20 Microns</td>
<td>-5</td>
</tr>
<tr>
<td>Stock Split</td>
<td>Asian Paints</td>
<td>-1.4</td>
</tr>
<tr>
<td>Consolidation</td>
<td>Akzo Nobel India</td>
<td>1.1</td>
</tr>
<tr>
<td>Consolidation</td>
<td>Mastek</td>
<td>2.5</td>
</tr>
<tr>
<td>Consolidation</td>
<td>Kanoria Chemicals</td>
<td>-2.11</td>
</tr>
<tr>
<td>Share Buy back</td>
<td>Resurgere Minerals</td>
<td>2.37</td>
</tr>
<tr>
<td>Share Buy back</td>
<td>Nissan Copper</td>
<td>3.36</td>
</tr>
<tr>
<td>Share Buyback</td>
<td>Arvind Remedies</td>
<td>0.47</td>
</tr>
</tbody>
</table>

The reference value of z score at 99% confidence level is +/- 2.58 in the case of two tailed test. The value is compared with the computed z scores given in table 2.

Stock Split  
The computed z score in table 2 shows that the two companies Tata Global beverages and 20 Microns fall outside the reference value of +/- 2.58 while that of Asian Paints is within the reference range.
Consolidation
The computed z score in table 2 shows that all the three companies selected have z scores within the reference range.

Share buyback
The computed z score in table 2 shows that Nissan Copper falls outside the reference value of +/- 2.58 while that of Resurgere Minerals and Arvind remedies is within the reference range.

Conclusion
The purpose of this study was to analyze the impact of announcement of corporate actions of Stock Split, Consolidation and Share buyback on the traded volumes of the shares on the stock exchanges.

Stock Split
Based on the above discussions, the null hypothesis needs to be rejected i.e., there is an impact of stock split on these shares in the case of Tata Global and 20 Microns. In the case of Asian Paints, the computed z score falls within the reference range and hence there is no reason to reject the null hypothesis.

Consolidation
In the case of consolidation, since the value of the computed z score falls within the reference value, there is no reason to reject the null hypothesis, i.e. there is no impact of consolidation on the traded volumes.

Share Buyback
Based on the above discussions, the null hypothesis needs to be rejected i.e., there is an impact of stock split on these shares in the case of Nissan Copper. In the case of Resurgere Minerals and Arvind Remedies, the computed z score falls within the reference range and hence there is no reason to reject the null hypothesis.

References: