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AN ANALYTICAL STUDY ON BONUS SHARE POLICY OF INDIAN LISTED COMPANIES AND ITS EFFECT ON FINANCIAL PERFORMANCE

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Abstract: *Worldwide investors are always on the lookout for the companies about to declare bonus shares. The two fold reasons for this are that firstly it gives instant appreciation due to jump in share price, andSecondly it indicates that the company under consideration has good future prospects.*

The present study is an attempt to establish relation of the dependent variable (Bonus shares) with independent variables (Pre Bonus 3 Year Revenue CAGR, Pre Bonus 3 Year Net Profit CAGR, Post Bonus percentage change in Revenue, Post Bonus percentage change in Net Profit, Pre Bonus Reserves to Equity ratio, Pre Bonus Turnover/Equity ratio, Promoter Stake percent at the time of Bonus, Increasing trend for Dividend before bonus), so as to predict as to when and in what ratio the bonus can be announced.

Keywords: *Bonus shares, Future prospects, Dividend payout, Equity capital, Bonus component, CAGR, Turnover Equity ratio*

INTRODUCTION

Lot of research studies areavailable on dividend policy but too little on bonus policy. It needs more study. Large free reserves, in addition to sustainability of growth in bottom-line should be the ideal case for issuing bonus shares. Promoter stake and size of operations with respect to equity capital should also have a bearing on the ratio of bonus shares declared. India being an emerging economy, the stock market is on the radar of domestic as well as foreign investors who poured in staggering 17 lac crores since the year 1991.

Bonus share has always generated considerable interest among investors be it retail or an institution domestic as well as foreign, as its declaration alone can get instant appreciation. Often markets are filled with bonus rumors and share price exhibits volatility. Unfortunately not much research has been carried out in this field.

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LITERATURE REVIEW

In the year 1978, L C Gupta found that a third of the companies under study did not raise the dividend quantum. Even significant number of companies reduced the dividend. In 1991 S. M. Gupta studied 25 large companies over a ten year period. It was concluded that bonus policy of companies was inconsistent (low bonus and irregular intervals). But this area needs further study as the sample was too small.

Shri Sarma S Narasimha (1993) studied the data from the year 1977 to 1988 and found that majority of the bonus issues were followed by increased dividend. The range of hike was large and in several cases, the past dividend percentage was maintained on the enlarged equity base.

Samir K. Barua, V. Raghunathan, and Jayanth R. VarmafromIIM, Ahmedabad (1994) concluded that "Considering the size, vintage and development of the Indian capital market, the total volume of research on it appears to be woefully modest - about 0.1 unit of work per institution per year!"

OBJECTIVES

(i) Study the financial performance of the company immediately after the declaration of bonus shares as compared to three years pre-declaration.

(ii) To analyse the bearing of Promoter stake, reserves, financial performance, Dividend, and size of operations on bonus share declaration.

RESEARCH DESIGN

Sample Design

Introduction

There are total 5391 company stocks registered for listing on BSE. Of these 3080 stocks are listed. Stocks listed on BSE are categorized into various groups like A-Group, B-Group, Z-Group and T-Group. Window for our analysis has been confined to only 'A' Group shares, as this group comprises of large market capitalization company stocks. Most of the companies are leaders in their respective sectors. Also, the group contains different market sectors and covers the whole economy of the country, like Cement, Steel, Textile, Automobile, Information technology, Leather, FMCG (Fast Moving Consumer Goods), Power generation, Finance, infrastructure, Fertilizer etc. The group has 235 numbers of stocks. Thus all the companies in "A" Group of BSE form the population. From the total population, the stocks have been selected based on the availability of the data.for the purpose of the present study sample of ten companies has been taken into consideration.

There are two stock exchanges actively being operated at national level–Bombay Stock Exchange (BSE) and National Stock Exchange (NSE), both are located at Mumbai. Almost entire company stocks listed on NSE is also listed on BSE. Thus, BSE stocks represent the whole universe/population. All the stocks listed on BSEare the Universe or Population for the subject study.

Parameters to be studied

Promoter stake: High promoter stake prompts the promoters to go for liberal bonus share ratio as it multiplies the quantity very fast and later they can go for private placement of shares with minimal dilution in their stake.

Reserves: Higher Reserves infuses confidence in Promoters to serve the enhanced equity capital easily.

Financial performance before and after the declaration of bonus shares–Consistently healthy financial performance makes the promoters confident to serve higher equity after bonus. Thus high 'Turnover to Equity' ratio is one of the key factors to determine the bonus declaration.

Dividend: The level and rate of increase in Dividend indicates the shareholder friendliness of the Promoters. Dividend is the only cash which flows directly from the company to its shareholders as long as the company is not wound up. Healthy and rising dividends are supposed to be a clear indicator of bonus in the offing.

Secondary type of data has been acquired from Bombay Stock Exchange website www.bseindia.com. As per the listing agreement all the companies are required to submit the desired data to BSE. Thus the quality of data is supposed to be of high quality.

Technique used for studying the three years data: CAGR (Compounded Annual Growth Rate).

Mathematically, it can be represented as

CAGR = Compounded Annual Growth Rate

= (Final amount/Initial amount) ^ (1/n)

Where,

n = Number of years

This has been derived from Compound Interest formula

i.e. $A = P\ (1 + r/100)n$

Where,

A = Final Amount

P = Starting or Principal Amount

R = Rate of Interest

N = Number of periods (mostly years)

ANALYSIS AND INTERPRETATION

The compound annual growth rate is very a useful measure of measuring growth over multiple time periods generally years. It can be considered as the growth rate that multiplies the initial investment amount to the final investment amount assuming that the investment has been compounding over the time period under consideration.

In other words CAGR is that geometric progression ratio that provides a fixed rate of return over the time period.

Analysis of Revenue and Net Profit CAGR for three years before declaration of Bonus

S. No.	*Company*	*Bonus Ratio*	*Bonus Date*	*Pre. Bonus 3 Year Revenue CAGR in %*	*Pre. Bonus 3 Year Net Profit CAGR in %*
1.	Adani Enterprise	1:1	10-Dec-09	6.78	47.18
2.	Ambuja Cements	1:2	20-Jun-05	19.24	34.37
3.	Ashok Leyland	1:1	02-Aug-11	36.34	82.28
4.	Bajaj Auto	1:1	08-Sep-10	14.80	49.98
5.	Biocon	1:1	11-Sep-08	12.94	80.51
6.	BPCL	1:1	13-Jul-12	31.62	–7.65
7.	Cadila Health	1:2	05-Apr-10	18.00	45.97
8.	Castrol	1:1	09-Apr-10	11.04	32.09
		1:1	04-Sep-12	13.39	12.34
9.	Container Corp	1:1	16-Apr-08	17.11	22.33
		1:2	06-Sep-13	7.28	3.59
10.	Crompton Gr.	3:4	08-Mar-10	17.01	43.67
	Average			17.13	37.22

Interpretation

(a) All the companies have reported positive Revenue CAGR for the three years before the declaration of Bonus shares.

(b) Except for BPCL all the companies have reported positive Net Profit CAGR for the three years before the declaration of Bonus shares.

(c) Average Revenue CAGR is placed robust at 17.13%.

(d) Despite one negative case the Net Profit CAGR is very robust at 37.22%.

Table 1
Analysis of Promoter stake at the time of Bonus and Revenue and Net Profit change in the year immediately after the declaration of Bonus.

S. No.	*Company*	*Bonus Ratio*	*Bonus Date*	*Post Bonus % change in Revenue*	*Post Bonus % change in Net Profit*	*Promoter Stake (%) at the time of Bonus*
1.	Adani Enterprise	1:1	10-Dec-09	–75	6	74
2.	Ambuja Cements	1:2	20-Jun-05	141	221	24
3.	Ashok Leyland	1:1	02-Aug-11	–3	–23	39
4.	Bajaj Auto	1:1	08-Sep-10	18	–10	50
5.	Biocon	1:1	11-Sep-08	28	122	61
6.	BPCL	1:1	13-Jul-12	8	54	55
7.	Cadila Health	1:2	05-Apr-10	8	8	75
8.	Castrol	1:1	09-Apr-10	9	–2	71
		1:1	04-Sep-12	2	14	71
9.	Container Corp	1:1	16-Apr-08	8	–1	63
		1:2	06-Sep-13	12	6	63
10.	Crompton Gr.	3:4	08-Mar-10	13	12	41
	Average			*14*	*34*	*57*

Interpretation

(a) Surprisingly in 2 out of 12 cases *i.e.* 17% of the cases the Revenue declined after the declaration of bonus.

(b) Average Revenue growth is only 14% after the declaration of Bonus as against 17% CAGR in previous three years.

(c) If one excludes the abnormally high Revenue growth of 141% achieved by Ambuja Cements and very steep decline of 75% by Adani Enterprises, the average Revenue growth sharply declines to just 10%.

(d) Net Profit growth is 34% in the year following the bonus issue.

(e) Astonishingly in 4 out of 12 cases *i.e.* 34% of the cases the Net Profit declined after the declaration of bonus.

(f) If one excludes the abnormally high Net Profit growth of 221% achieved by Ambuja Cements, the average Revenue growth sharply declines to just half to 17%, much below the three years CAGR of 37.22% before declaration of bonus shares.

(g) Average Promoter stake at 57% is reasonably high. Capital intensive companies like Ambuja Cement, Ashok Leyland and Crompton Greaves have low promoter stake as expected.

Table 2
Analysis of Pre-Bonus 'Reserves to Equity' ratio, Pre-Bonus 'Turnover to Equity'ratio, Dividend trend and compounded annual growth rate of Dividend for three years before declaration of Bonus

S. No.	*Company*	*Bonus Ratio*	*Bonus Date*	*Pre Bonus Reserves to equity ratio*	*Pre Bonus Turnover/ Equity ratio*	*Pre Bonus Increasing trend for Div.*	*Previous 3 years dividend CAGR %*
1.	Adani Enterprise	1:1	10-Dec-09	65	468	✓	49
2.	Ambuja Cements	1:2	20-Jun-05	10	11	✓	15
3.	Ashok Leyland	1:1	02-Aug-11	19	84	✓	41
4.	Bajaj Auto	1:1	08-Sep-10	19	82	✓	41
5.	Biocon	1:1	11-Sep-08	26	18	✓	41
6.	BPCL	1:1	13-Jul-12	40	586	✓	-11
7.	Cadila Health	1:2	05-Apr-10	23	36	✓	5
8.	Castrol	1:1	09-Apr-10	3	19	✓	34
		1:1	04-Sep-12	1	12	✓	-23
9.	Container Corp	1:1	16-Apr-08	48	52	✓	1
		1:2	06-Sep-13	47	34	✓	6
10.	Crompton Gr.	3:4	08-Mar-10	16	63	✓	20
	Average			*26*	*122*		*18*

Interpretation

(a) Reserves to Equity before declaration of Bonus was highat 65 times for Adani Enterprises.

(b) Average ratio of Reserves to Equity before Bonus declaration is reasonable at 26 times.

(c) Turnover to Equity before Bonus for Adani Enterprises is way higher than the average value, as it is a trading company. Same is the case with Oil companies like BPCL

(d) Average Turnover to Equity ratio is 122 times, which is substantially on higher side.

(e) If we remove the abnormally high figures of Adani Enterprises and BPCL the average Turnover Equity ratio declines to 41 which is pretty reasonable.

(f) Average CAGR increase in Dividend for the three years prior to declaration of Bonus is reasonable at 18%, which is low. But considering that in case of Castrol and BPLCL this growth has turned negative of 23% and 11% respectively, the average growth would have been 25% which is reasonable considering the the Net Profit during this period has increased by 34%.

(g) In 2 cases out of 12, the Dividend increasing trend is missing before Bonus declaration. Since both these negative growth companies (BPCL and Castrol) are from the oil sector, it is a industry specific issue.

FINDINGS/CONCLUSION

Based on the tabulated data there is conclusive evidence that the companies pay bonus shares when most of the below mentioned criteria is met.

(a) Last three years Sales and Net Profit CAGR is about 17% and 37% respectively.

(b) There is a strong beliefamong stock investors for healthy financial performance post declaration of bonus shares. But the study suggest otherwise–in the year immediately after the declaration of bonus shares the average increase in turnover is mere 10% (excluding abnormally high figures) against previous three year CAGR of 17% and the average increase in Net Profit is mere 17% (excluding abnormally high figures) against previous three year CAGR of 37%.

(c) Reserves to Equity ratio at 26 before declaration of bonus is bit high compared to general perception of 15 to 20 times. This can be partly explained by high value of 65 in case of Adani Enterprises.

(d) Turnover to Equity ratio at 122is also very high against general perception of about 20 to 30 times. Excluding the abnormally high figures of Adani Enterprises and BPCL due their nature of business, the ratio comes down to 41, which is still on higher side than market expectations.

(e) Average Promoter stake of 57% is fully justified and in line with the investor expectations of high promoter stake. Low floating stock prompts the promoters to declare bonus shares so as to increase the liquidity of shares in the market. This ratio could have been still higher but for the capital intensive companies like Ambuja Cement, Ashok Leyland etc.

(f) If we remove industry specific trend, all the companies under consideration have shown increasing Dividend payments.Steadily increasing Dividend payout, reaffirms the fact that the increasing availability of cash and shareholder friendliness prompts the company to declare bonus.

(g) Three years before the bonus issue, the Dividend has been increased at CAGR of 25%, which is two-third the growth in Net Profit at 34% (after removing the abnormal cases). Probably the reason could be to serve higher equity in times to come due to bonus shares.

(h) Thus there is conclusive evidence that-

    (i) High turnover to Equity ratio (about 41 in our case), three years CAGR of 17% in Sales and 37% in Net Profit, High Reserves to Equity ratio (about 26 in this case), High Promoter stake (about 57%), and consistent rise in Dividend are the key parameters for Bonus consideration.

(ii) Against the strong investor perception of better financial performance after the declaration of bonus shares, the study suggests otherwise wherein Sales growth has declined as much as 41% (10% growth against 17% before bonus) while Net profit growth plunged as much as 54% (17% as against 37% before bonus).

One of the reasons could be that the companies declare bonus when they witness steady growth in financial parameters for 3 to 4 years consistently but are caught unawares that the business cycle was at peak. This needs further research and study.

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