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BONUS ISSUE ANNOUNCEMENTS AND ITS IMPACT ON SHARE PRICES OF COLOMBO STOCK EXCHANGE (CSE) IN SRI LANKA

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ABSTRACT

Over the year's bonus issues announcements and share prices have been subjected to many empirical discussions within the finance literatures. To the knowledge of the researchers very few studies have attempted to observe bonus issue announcement and share prices in Sri Lanka. In attempt to fill this research gap the present study was initiated to find out the impact of bonus issue announcements on share prices. Primary information and secondary data were collected from Colombo Stock Exchange (CSE). The present study used the 'standard-event study methodology' to examine the impact of bonus issues announcement on share prices. The study was identified sixty-seven events (32 Companies) listed in the CSE for the period from year 2003 to 2007. These sixty-seven events are divided into financial sector and non financial sector. Several interrelated procedures are performed through t-test by the researchers during the data analysis procedures. Operational hypotheses were formulated and results revealed that 43% of Abnormal Returns (ARs) are positively and 57% of ARs are negatively on the event day "0" (announcement day). In addition the bonus issue announcements have insignificant impact on share price of the CSE i.e., 5% level or 10% level of level of significance. Outcomes of the study will be useful to the academicians, practitioners, policy makers and investors for making suitable policy formulations for the companies. Further the companies are able to decide a suitable polices in executing their financial decision without harming to the market value of the shares.

Key Words: Bonus Issue Announcements; Share Prices; Colombo Stock Exchange (CSE).

INTRODUCTION

In any country, capital market is an important body in contributing economic development. It has traditionally been viewed as an indicator or predictor of the economy. Many believe (CSE Fact Book, 2005), that a decrease in stock prices signals a slowdown in the economy, whereas an increase in stock prices is evidence of growth. Over the years bonus issues and share prices have been subjected of much empirical discussion within finance literatures. It is evident from the theoretical perspectives that bonus issues increase the number of equity stocks outstanding but have no effect on stock holder's proportional ownership of stocks. The bonus issues date is known well in advanced and therefore should contain no new information. As such, one would not expect any significant price reaction on bonus issue announcement. Contrary to this theoretical prediction, however empirical studies of bonus issues and stock dividends have documented a statistically significant market price reaction. It is therefore a matter of concern that firms announcing bonus issues experience rise in their stock prices on an average supporting semi-strong form Efficient Market Hypothesis (EMH) (Fama, 1970).

The greatest amount of research in finance has been devoted to the effect of an announcement on share price. These studies are known as 'event studies'. Initially event studies were undertaken to examine whether markets were efficient, in particular, how fast the information was incorporated in share price. Dividends and earnings has been an interesting issue of theoretical and empirical research since the pioneering work of Fama, Fisher, Jensen and Roll [1969, as cited in Bandara and Lalith. (2002)]. There is a preponderance of evidence that dividends play an important role in capital market. Dividend policy is considered one of the most crucial issues for management decision, because it serves as a communication tool between management and investors. Investors do not always trust managers to provide unbiased information about their companies' prospects, but dividend signals are relatively reliable, because they require cash payments and cash cannot be easily manipulated. Therefore, the aim of this study is to examine the share price

reaction to information release of bonus issues with the view of examining the whether Sri Lankan stock market is semi-strong efficient or not.

In Sri Lanka also CSE plays a major role in contributing much towards economic development. CSE is emerging trend in Sri Lanka. The peace process, relatively stable political environment, foreign aid, low interest rate scenario, improved economic fundamentals and the increased listed company profitability had a positive impact on the performance of the CSE.

BACKGROUND OF THE RESEARCH PROBLEM

One can argue that Sri Lanka is not an ideal setting to study this issue, in light of the limited role of the stock market in the economy. But in this respect Sri Lanka is not too different from many other countries, where the stock market is underdeveloped relative to the scale of the economy. Even European (Korea and Italy) and Indian markets are fairly similar to our market. Most of the works on the impact on earnings announcement on stock prices pertains to the US market. Relatively little is known about other parts of the world, especially on the developing capital markets.

PROBLEM STATEMENT

Examining the market reaction to bonus issue announcements or its impact on shareholder's value in an emerging market like Sri Lanka can be a fruitful empirical work, which may likely to differ from a developed market. There is not much widely cited empirical works on CSE especially impact of bonus issue announcements on share price. Further, it can be outlined as "The market reaction to bonus issue announcement of the companies listed in CSE". From this research, the researchers are able to find out the following research questions.

RQ₁: Do the bonus issue announcements have significant impacts on share prices of companies traded on CSE?.

RQ₂: Whether bonus issue announcements have significant different impact on the financial sector Vs non financial sector?.

OBJECTIVES

1. To find out the impact of bonus issue announcements on share prices.
2. To identify the different impacts of finance and non-finance sector.

LITERATURE REVIEW AND HYPOTHESES

Balachandran (2005) examined share price reaction to announcement of bonus share issues of Australian companies (equivalent to stock dividends in the US and scrip issues in the UK). Price reaction to bonus issue announcements from the day of the announcements to the day after the announcements (day 0 to day 1) is statistically significant and positive of average 2.37% for uncontaminated events and 2.11% for contaminated events employing the market model. Shelina and Misir (2006) stated the weak-form efficiency of Dhaka Stock Exchange (DSE), an emerging capital market in Bangladesh. The study found that under weak-form of efficiency, stock prices of the listed companies of DSE change independently over time and that no investor will be able to earn abnormal profits. Nasir (2007) found the impact of the PN4 announcements to the share returns of the announcing firms listed on the Bursa Malaysia using 73 sample firms for the period 2001-2004. The results support that the market is not totally efficient in its semi strong form. Consistent with the overnight reactions reported in other studies, there exist significant abnormal returns, with the largest negative return on $t+1$ (-16.8%). Negative significant returns are also shown for the next 5 days post announcement date, possibly due to follow-up announcements made by the 'PN4' firms immediately after the first announcements. The results generally show that the investors do not adjust to the information quickly and therefore the abnormal returns exist after the public information is available.

Katerina, Apostolos, Demetrios and Thomas (2007) expressed the stock price reaction to interim dividend announcements of Greek firms listed on the Athens Stock Exchange (ASE) under the special legal framework of pertinent dividend policy that holds in Greece and differs from the one in the other developed economies. Bandara and Samarakoon (2002) investigated the informational content of dividend announcement and analyzed the impact of dividend announcement by firm size and dividend growth using a sample from the emerging market of Sri Lanka. They found that dividends have significant information content in the Sri Lankan stock market. On average, market reacts positively to dividend announcement. The information content is stronger for smaller firms and for firm's announcing high dividend growth. They also found considerable anticipatory effects for smaller firms, the largest firms and for firms announcing lowest dividend growth. Finally concluded the results are inconsistent with an information efficient stock market.

Abeyratna (2005) mentioned that the stock market over-reaction hypothesis using monthly share returns for the equities traded on the CSE. He employed the conventional methodology, but in order to overcome the potential bias imposed by non-synchronous trading, He used Dimson's aggregated coefficients method in estimating the market model. The findings support the notion that investors over-react in this emerging market; the loser portfolio

outperforms its winner counterpart by a statistically significant amount. The over-reaction observed is asymmetric; it is more pronounced for losers than for winners. Even though the differences in firm size do not seem to influence the findings of the study, month of the year seems to be affecting the overreaction findings.

According to the Ramesh (2007) dividends have a stronger signal and significant information content in the CSE. On average, market reacts positively to dividend announcement. Further he found that the dividends announcement are stronger for manufacturing companies, non-manufacturing companies, smallest firms, third largest firms, and largest firms. Abayadeera (1999) examined the relationship between the dividend policies of firms and selected macroeconomic variables, using a sample companies quoted in the Colombo Stock Exchange. The dividend policy variables are defined as dividend per share, dividend rate, dividend payout, and dividend yield, while GDP growth, money supply growth, inflation, and interest rates are employed as explanatory variables. The relationship is examined by a cross-sectional, time series regression method. He found that GDP growth, particularly the current and future growth, is significantly positively related to dividends. Current and future inflation is reliably related to dividends. Most of these reliable relationships remain significant even in multiple regressions.

Michelle and Shiguang (2001) pointed out the issues with a high bonus ratio (number of bonus shares in the issue/number of existing shares) usually attract positive returns and the issues with a low bonus ratio are rewarded with negative returns. From the literatures we can say that several researchers have been supported that the dividend announcements impact on the share price of the firm positively or negatively. But we could not find any researches of bonus issue announcement on share price in Sri Lanka. Therefore Authors took interest somewhat cover this research gap. In addition based on the literatures, the following hypotheses are formulated for testing validity of the study.

H₁: Bonus issue announcements have significant impacts on the share price of the securities traded on CSE.

H₂: Bonus issue announcements have no significant different impacts on the financial sector Vs non financial sector.

METHOD

Research Approach

As this study is a business and management research, it has a characteristic of positivist and interpretive and also involves in deductive approach as well as inductive approach. Combining these two research approaches in same piece of research is perfectly possible and advantageous for a research.

Sampling Design

For the purpose of measuring the impact of the informational bonus issues on the share prices, an overall sample sixty-seven events (32 companies) listed in the CSE is selected. These sixty-seven events are divided into financial sector and non financial sector. The financial sector consists sixteen events while the non-financial companies consists thirty-three events over the period of January 2003 to April 2007 which were selected by using judgmental sampling. This choice of the sample period is

governed by the availability of data. Reasonable care has been exercised in order to select a large sample to derive more valid findings.

Design of Experiment

In the present study we used only secondary data which is the CSE's C-D. The study computes daily returns for individual securities on the basis of daily closing stock prices. In cases where price for the non-traded on a given date, the following traded price is taken as the price for the non-trading date. The market return is calculated as the change in the All Share Price Index (ASPI), which is the value-weighted price index of the entire share listed in the CSE.

Reliability and Validity

Primary information and data were collected from CSE which is found that all information is accurate and realistic. Therefore researchers are highly satisfied with the data.

Validation procedures involved initial consultation with expert researchers. The experts also judged the face and content validity of the data which were collected from CSE.

Data Analysis and Techniques

This study uses the 'Standard Event Study Method' (Brown and Warner,1980,1985) to estimate the abnormal returns (AR), average abnormal returns (AAR) and cumulative average abnormal returns (CAAR) around the bonus dividend announcements day (the event-day). In the study, researcher has taken 21 days around the event (dividend announcement date), and study has designated -10,-9,-8-1 as the 10 days prior to the event, 0 as the event day, and +1, +2, +3....., +10 days after the event and AAR and CAAR were computed for 21 days surrounding (lead and lag 10 days) the event-day.

FINDINGS OF THE STUDY

The study identifies the number of positive direction and negative directions of abnormal returns (AR) on the bonus announcement date (event day = 0) are presented in table 01 that is how the market react for the information of bonus issue announcement on the event day

Table 01: Direction of Abnormal Returns (AR%) on Day 0 of Overall Sample

Direction	2007		2006		2005		2004		2003	
	No	%	No.	%	No.	%	No.	%	No.	%
Positive	3	100	3	18.75	9	41	9	50	5	62.5
Negative	0	0	13	81.25	13	59	9	50	3	37.5
Total	3	100	16	100	22	100	18	100	8	100

Source: CSE's C-D(2007)

The table 01 shows that the bonus issue may be information content of mix of both negative and positive

reactions. In year 2003 62.5% of the events have positive returns while 37.5% reported as negative reaction. But in year 2004, there were equal reactions of negative and positive. In 2005 there was a negative reaction as 59% but on the other hand 41% of positive reactions. The negative reaction continued to increase in the 2006, 81.25% negative reactions of the events have observed in this year. It has changed when compared to the previous year 100% of events reacted as positively in 2007. In the table 02 shows the number of positive direction and negative direction of abnormal returns (AR) on the Bonus issue date (event day = 0) over the study period.

Table 02: Direction of Abnormal Returns (ARs) on Day 0 of Overall Sample

Direction	Number	%
Positive	29	43
Negative	38	57
Total	67	100

Source: CSE's C-D(2007)

It is evident from the table 02 that the bonus issue may be an informational content in the overall study period 43% of the events have only positive ARs while 57% of the events have negative ARs. It is interesting to observe that while positive and negative events are fairly evenly distributed.

Table 03: Direction of Abnormal Returns (ARs) of the Window Period for Total Observation for the Study Period of 2003 - 2007

Direction	2007		2006		2005		2004		2003	
	No	%	No.	%	No.	%	No.	%	No.	%
Positive	22	35	138	41	164	35	156	41	78	46
Negative	41	65	198	59	298	65	222	59	90	54
Total	63	100	336	100	462	100	378	100	168	100

Source: CSE's C-D(2007)

It is found that from the table 03 the direction of abnormal of the window period, which shows the abnormal returns are negative in all years. In year 2003 there are 46% of abnormal returns are positive 54% of the abnormal returns are negative. In year 2004 also the situation is same as previous with the negative direction of AR is 41%. But in 2005 65% of abnormal returns are negative while 35% of abnormal returns are positive. In year 2006 the negative direction of AR is 59% and the positive direction is 41%.The trend of abnormal return is also negatively directed with 35% positive and 65% negative direction of the AR. In addition, in the table 03 shows the number of positive direction and negative direction of abnormal returns (AR) of the window period (-10 to +10) for total observation.

Table 04: Direction of Abnormal Returns (ARs) of the Window Period for Total Observation

Direction	Number	%
Positive	558	40
Negative	849	60
Total	1407	100

Source: CSE's C-D(2007)

The above table 04 shows the direction of Abnormal Returns (ARs) of the window period for total observation of whole sample and the all events are 1407. 40% of abnormal returns are positive while 60% of abnormal returns are in negative direction. So bonus issue announcement impact on the CSE 60% negatively and 40% positively.

If the event is statistically significant that might be due to leakage of the board of directors' decision to propose the bonus the fact that the information of issue or insiders' trading activities. However, no theory can be offered on why leakage should occur on these specific dates. The following table 05 shows the aggregate average abnormal returns (AAR) of overall sample over the study period of 2003 to 2007.

Table 05: Average Abnormal Returns (AAR) of Overall Sample

Event Date	AAR%	T(AAR)
-10	0.88	0.26
-9	-0.40	-0.11
-8	-16.12	-4.66***
-7	-2.15	-0.62
-6	-1.28	-0.37
-5	-1.27	-0.37
-4	-0.42	-0.12
-3	-0.68	-0.20
-2	-0.90	-0.26
-1	-0.22	-0.06
0	-0.82	-0.24
1	-0.75	-0.22
2	-0.45	-0.13
3	0.27	0.08
4	-1.19	-0.35
5	0.09	0.03
6	-0.78	-0.23
7	0.50	0.14
8	-0.32	-0.09
9	-0.49	-0.14
10	-1.58	-0.46
*** Significance at 1%		

Source: CSE's C-D(2007)

The t-statistics indicate whether the aggregate average abnormal return is significantly different from zero. According to the result the aggregate average abnormal return on the bonus issue date (event day = 0) is -0.24% which is not statically significant at 5% level or 10% level. This means that there were no information leakages prior to the announcements of bonus issue. So that the event day

and pre-announcement period except day-8 is not statistically significant at 5% level or 10% level.

Table 06: Cumulative Average Abnormal Returns (CAAR) of Overall Sample

Window	CARR%
(-10,-1)	-22.55
(0,+10)	-5.53
(-2,+2)	-3.14
(-1,+1)	-1.79
(0,+5)	-2.86

Source: CSE's C-D(2007)

The Cumulative Average Abnormal Return (CAAR)% for all the event period is in negative. The CAAR for (-10,-1) is -22.55%.the CAAR for the period of (0, +10) is -5.53%. It indicates there is negative reaction around bonus issue announcement. The CAAR for the period (-2,+2) is -3.14% , -1.79% in the period (-1,+1), and for the period (0,+5) is -2.86%. The negative response reduces toward the post announcement days. In the table 07 illustrates the number of positive direction and negative direction of abnormal returns (AR) on the announcement date (event day = 0) in the financial sector and non-financial sector over the study period.

Table 07: Direction of Abnormal Returns (ARS) on Day 0 by Sector.

Direction	Finance		Non Finance	
	Number	%	Number	%
Positive	11	48	18	41
Negative	12	52	26	59
Total	23	100	44	100

Source: CSE's C-D(2007)

The above table 07 shows that the bonus issue effect may be an informational content in financial sector and non financial sector in the overall study period. The positive abnormal return is 48% of the events in the financial sector, while in the non-financial sector is 41%. The negative direction is 52% of the events in the financial sector 59% in the non-financial sector. That is the direction of the abnormal return is almost equal in both cases. In the Table7.8shows the number of positive direction and negative direction of abnormal returns (AR) of the window period (-10 to +10) for total observation by firm sector

Table 08: Direction of Abnormal Returns (ARs) of the Window Period for Total Observation by Sector

Direction	Finance		Non Finance	
	Number	%	Number	%
Positive	182	38	375	40
Negative	301	62	549	60
Total	483	100	924	100

Source: CSE's C-D(2007)

In the financial sector 38% of the AR is in positively directed and 62% negatively directed. In non-financial sector 40% of AR is positive direction and 60% is in negative direction. The bonus issue may affect 38% positively 62% negatively in the financial sector. In the non-financial sector, the affect may be 60% negatively and 40% positively.

Testing Hypotheses

H₁: Bonus issue announcements have no significant impacts on the share price of the securities traded on CSE. The average abnormal returns are -0.81% on the announcement date (event day = 0). These reflect the bonus issue creates -0.81% abnormal returns 43% of ARs are positively and 57% of ARs are negatively on the event day 0 (announcement day). Therefore the bonus issue announcements have no significant impact on share price of the CSE. Therefore the H₀₁ is accepted.

H₂: Bonus issue announcements have no significant different impacts on the financial sector Vs non financial sector.

The average abnormal return is -1.65% in the financial sector and -0.94% in the non financial sector on the announcement date (0). 48% of ARs are positive direction and 52% of ARs are negative direction in financial sector and 41% of ARs are positive direction and 59% of ARs are negative direction in non-financing sector. 38% of the ARs are positive direction and 62% of ARs are negative direction in financial sector and 40% of ARs are positively reacted and 60% of ARs are negatively reacted in the non-financial sector in the overall window period (-10 to +10). Here there are no significant different in the financial sector Vs non financial sector. Therefore the H₀₂ is accepted.

DISCUSSION AND RECOMMENDATIONS

The study examines the stock price reaction to the information content of bonus issue with the view of the CSE is semi-strong efficient or not. The period of the study is January 2003 to April 2007. Sixty seven (67) bonus issues i.e., events have been used to study the announcement effect by using the standard event study methodology. This study aimed to find out the price reaction to bonus issue announcement. More specifically, this study addresses two major empirical issues. (a) How does the Sri Lankan share market respond to bonus issues? (b) Does the market response vary according to firm sector to bonus issue? These issues are investigated using the standard event study methodology. Finally the empirical results for the overall sample provide strong evidence consistent. The analysis of the market response by overall sample and firm sector (financial and non financial) indicates that the most of the bonus issues impact on the stock market negatively. The findings of the market reaction bonus issue significantly impact on the share price of the CSE on the pre-announcement period rather than on the event day or post-announcement days. Bonus issues have no significant different impact on the financial sector Vs non financial sector. This research indicates the CAAR of the pre-announcement (-10,-1) is -22.55% while on the post-announcement days is -5.53%. This indicates that the bonus issues negatively responses in the share price. This also reveals that there is information leakages prior to the announcement day of bonus issue. The Sri Lankan stock market is negatively responses to the bonus issue announcement, because the Sri Lankan stock

market is an inefficient market and the bonus issues are not made frequently.

DIRECTIONS FOR THE FUTURE RESEARCHES

It is emphasized at the beginning of this study that in Sri Lanka, there is fewer attempts taken to study of bonus issue announcement and impact on share price. Therefore followings may be some directions or researchable issues which can be worthy for future studies in the area of dividend announcement.

Study on "Comparison for effect of interim and final dividend announcement on share prices".

Study on "Comparison of share price reaction to dividend announcement - developed countries vs. developing (or least developed) countries".

Furthermore a study can be conducted to extend this study too, since this study considers only a limited number of variables. It is obvious that economic, political variables and trading frequency may be important for determinations of share price.

CONTRIBUTION OF THE STUDY

It is hoped that the study will contribute greatly to the literature of bonus issue announcements and share price of Sri Lanka. The suitable policy formulation, based on the findings of the study, to the best interest of the investor as well as of the country will go a long way to open a new era in the field of the country's economic development and growth.

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