

## **CHAPTER 1: OVERVIEW**

### **1.1 INTRODUCTION**

Kuala Lumpur Stock Exchange (KLSE) investors love bonus issues, which is quite evident as stock prices typically receive a boost upon a bonus announcement and a further positive reaction when the entitlement ex-date is announced.

As it is, the common perception is that the bonus issue is a freebie and hence it must be good. The logic is not entirely wrong, given that shareholders are issued new shares free of charge, but what should be noted is that the bonus shares do not represent additional ownership. In fact, they are nothing more than what you already own.

Just as dividend is a distribution of cash in the company (which shareholders already own) to shareholders, the bonus issue is only a re-denomination of ownership. There is no fundamental change. The company is still operating from the same asset base with the same staff and generating similar levels of returns as with pre-bonus days. The only change is the capital base.

As everything else remains constant, on a per share basis, the same assets and profits would be divided over a bigger number of shares (dilution effect). And valuation does not change as the share price would be adjusted accordingly to reflect the expanded capital base.

Theoretically, bonus issues will not create any additional value to the shareholders. Empirical studies by other researchers have concluded that bonus issue has no direct cash flow implications on the value of the firm and hence the price of its shares. In other words, the wealth of the shareholders will not change.

One fact stands out is that bonus issues do not increase total net worth. Any rational investor should therefore treat a bonus issue as a non-event. However, the stock market indicate otherwise. Bonus issues are usually greeted with tremendous interest by market participants in Malaysia.

In an efficient market, bonus issues will not have a positive effect on share prices. If the shareholders wealth is not increased, then why do companies still issue bonus shares? Why are investors still bidding up the prices of the stocks which have issued bonus shares? Why have counters on the KLSE which have recently announced bonus issues shown significant increase in trading volume and price increase?

The positive reaction of the investing public is puzzling. Their enthusiasm drives prices and volume up whenever bonus issues are made. This phenomenon is not unique to the Malaysian stock market as it is seen in most major stock markets in the world. The question that arises then is – Are investors being misled by the bonus myth? Are the investors going to be losers when they adopt this positive attitude? Or is there something more concrete behind this reaction to bonus issues?

However there are benefits in bonus issues. Bonus issues do contain favorable information about the company. So, are the investors receiving “signals” telling of prosperous times ahead via the bonus issue message?

## **1.2 OBJECTIVE OF THE STUDY**

This study examines the effect of the announcement date and ex-date of the bonus issues declared on the Kuala Lumpur Stock Exchange (KLSE) from January 1997 through December 2001. Other criteria for the selection of these bonus issues are specified in Chapter 4.

The three (3) research objectives are:

1. To determine the effect of bonus issues announcement on the behavior of the stock prices.
2. To determine the effect of bonus issues ex-date on the behavior of the stock prices.
3. To determine the effect of different distribution ratios of bonus issues on the behavior of stock prices.

Findings from this study will also serve as a direct test of the semi-strong form of Efficient Market Hypothesis on the Malaysian Stock Market. If the market is efficient in the semi-strong form of the Efficient Market Hypothesis, then there should be no abnormal return after the event date.

### **1.3 SIGNIFICANCE OF THE STUDY**

The findings of this study will be of great interest to investors, stockbrokers, fund managers, the KLSE and academicians. It will further enlighten our understanding of the behavior of stock returns on the Malaysian Stock Market.

This study shall reveal whether or not the investors actually react favorably to the various classes of bonus issues about the announcement dates and ex-dates in the past.

This study will also reveal whether the different distribution ratios of the bonus issues have any impact on the investors' decisions to invest in those stocks.

If the past can be considered as an indication of what the future might be, then the findings of this study will help analysts and investors in making a more informed decision in formulating a trading strategy with regards to its distribution ratios to maximize their returns.

The result can help companies to determine the appropriate time and means to make the bonus issue announcements and how to strategically position these announcements in order to attract more investors. These findings will be reliable because they are based on empirical evidences.

## 1.4 ORGANIZATION OF THE STUDY

*Chapter 1* introduces the subject and specifies the study's objectives as well as its significance.

*Chapter 2* discusses the theory and reasons behind bonus issues and the Efficient Market Hypotheses.

*Chapter 3* reviews literature of past empirical findings and how it relates to the research study and their shortcomings.

*Chapter 4* outlines the research methodology and details the sampling framework and the methods used to collect and analyze the data.

*Chapter 5* gives the findings of the analysis of this research study. It also touches on the explanations for the behavior observed.

*Chapter 6* summarizes the findings of the study, its limitations and provides some recommendations for further research.