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Issuance of Stock Dividends or Bonus Shares: A Case Study of Carlsberg Brewery Malaysia Berhad

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Abstract

This study investigates the specific and conclusive reasons why a company issues bonus shares, as well as the rationale and the best timing for bonus share issuance. The study examines Carlsberg's annual reports from 1988 to 2004 to evaluate the factors that influence bonus share payments and timing. Examine supporting evidence from other businesses as well. An analysis of Carlsberg Brewery Malaysia Berhad's bonus shares granted from its inception to 2004 found that the announcement of bonus shares would increase the company's share price. As a result, the findings suggest that bonus shares are issued to correct market asymmetry. This research supports the idea that issuing bonus shares would increase the stock price, resulting in increased liquidity. Hence, companies issue bonus shares to boost their liquidity and to convey private positive information to their shareholders. This research adds to the literature by focusing on the timing and key features of bonus share issuing. It implies that dividend policy should be customized to market imperfections. As a result, dividend policies would differ significantly between organizations based on the weights each of the imperfections has on the firm and shareholders.

Keywords: Bonus Shares, Dividend Policy, Stock Splits, Malaysia

JEL Classification Code: D53, E44, G14, N24

1. Introduction

According to the firm theory, the most important objective of a company's existence is to maximize shareholder wealth. Shareholders maximize their wealth through the increase of the share price and payment of cash dividends. There is also another type of dividend that could be issued by the company which is known as stock dividends or bonus shares. Bonus shares are distributed to shareholders by capitalizing on retained earnings. It does not involve the use of cash flow. Bonus shares dilute the Earnings Per Share as well as the Net Tangible Asset of the company. It does not change the percentage of shareholding by the investor. The board of directors must authorize the bonus shares, which will be issued to all shareholders who bought the stock before the ex-dividend date. The ex-dividend date is the date when the right to the dividend leaves the stock. This means the purchaser of the stock on or after the ex-dividend date would not receive the dividends declared.

Dividend policy remains a puzzle. Corporations may pay dividends to reward investors who invested in their companies or to encourage shareholders to buy the shares at a higher price. On the flip side, a corporation that does not pay dividends may have a desire to invest in attractive investment projects. These companies do not pay dividends as not to miss out on investment projects. Subsequently, their capital appreciation would be greater than the declaration of dividends. Based on the above situation, it can be seen that the declaration of dividends is a puzzle for financial economists till today. This paper would concentrate on analyzing the reasons a company declares bonus shares and the optimum timing of the declaration of bonus shares.

From the literature reviews, there have been various theories regarding the reasons firms issue bonus shares. The numerous reasons include communicating future positive information about the firm, realigning the stock price to an appropriate trading range, signaling a permanent boost in company earnings, and ensuring compliance with the

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company's target pay-out ratio. Bonus shares are also well received by investors, increasing the firm's liquidity. The findings of the preceding ideas, however, are hotly debated. This is because the preceding theories were not tested with the behavioral and psychological influences of the reasons for issuing bonus shares in mind.

Effectively, the research problems are summarized below:

a. No specific and conclusive reason to determine the exact reason a company issues bonus shares; and
b. No specific and conclusive reason for a company to determine the best timing of the issuance of bonus shares.

The objectives of the research are:

a. To suggest specific and conclusive reasons a company issues bonus shares; and
b. To suggest the best timing for the issuance of bonus shares.

Companies issue bonus shares for various reasons and at differing times from each other.

This study focuses on the specific and conclusive reasons a company issues bonus shares and suggests the best timing of the issuance of the bonus shares. In addition, the relationship between the issuance of cash dividends and bonus shares is also explored.

2. Literature Review

The survey of literature covers various studies done by authors to explain the reason companies issue bonus shares or stock dividends and stock splits. It also analyses the relationship between aggregate dividend behavior and permanent earnings hypothesis, the relevance of dividend policy, and the role of signaling of stock splits and stock dividends to the value of the firm.

2.1. Reason Companies Issue Bonus Shares and Stock Splits

Sharpe et al. (1999) explained the reason many firms or companies issue stock dividends or stock splits. It is mainly due to the fact that stockholders respond positively to evidence of growth in their corporation. Stock splits are used by management to signal to the investors that the firm's stock is undervalued. Danila et al. (2020) argued that firms' growth opportunities have a significant negative correlation with debt ratio and dividend yield suggesting that firms with high growth opportunities are discouraged to generate debt to resolve underinvestment and asset-substitution problems. Another view is that stock splits and stock dividends may bring the stock's price to a more desirable trading range. This would encourage investors to invest in the stock market and increase the liquidity of the stock. Stocks have a positive abnormal return of about 54% before the announcement of the stock splits. The unexpected positive development could be due to factors such as the unexpectedly large increase in earnings. The stock returns increased over 3% in the period two days before and two days after the announcement of the stock split. In the following year, the investors received significantly positive abnormal returns around 8%. Subsequently, no notable abnormal returns occurred.

However, other studies using different stocks and time periods found slightly negative abnormal returns. In addition, stock splits are also associated with increased transactions costs. The costs which increase are commission costs and bid-ask spreads which are unfavorable to the investor. Stock dividends and stock split also uncovered apparent market inefficiency. An investor who bought the shares of the firm before the ex-dividend date and sold them the day after the ex-dividend date would make an abnormal return of roughly 2% for stock dividends and 1% for stock splits. This violates the efficient markets theory because investors make an abnormal profit based on publicly available information. This article analyses the reasons for declaring stock dividends and stock split but does not give conclusive evidence on reasons a company issues stock dividends. Vijayakumaran and Vijayakumaran (2019) found that managerial ownership only affects the leverage decisions of private firms in the post-2005 split share reform period.

Brigham and Daves (2003) linked the issuance of stock dividends and stock splits to the firms' cash dividend policy. The authors gave an example of Porter's Electronics Inc (Porter). Since its inception, Porter's markets have been expanding and the company has enjoyed growth in sales and earnings. Some of their earnings had been paid out as cash dividends. As the years went by, the stock prices were so high that few people could afford to buy a round lot of 100 shares. The company issued stock splits to align its shares to the optimal price range. Therefore, many financial managers believe that an optimal price range exists for stocks. Stock splits would ensure that the firm trades its shares within the optimal trading range. In respect of stock dividends, the total number of shares for a company is increased and this would result in earnings, dividends, and share prices declining. Stock splits are used after a large price run-up whilst stock dividends would keep the stock price within the optimal trading range.

Many empirical studies have attempted to determine the value of the stock after it announces a stock split or a stock dividend. The price of the stock would rise shortly after it announces a stock split or a stock dividend. Investors take stock splits and stock dividends as signals of higher future

earnings and dividends. However, in the next few months, if the company does not announce an increase in earnings and dividends, the stock price would drop to the level before the announcement. In addition, brokerage commissions are generally higher in higher percentage stocks. The authors concluded that stock dividends provide management with a relatively low-cost way of signaling their company's prospect for the future is good. Microsoft, Hewlett Packard, and Wal-Mart are some of the companies that would be extremely costly if those companies did not split their stock. The authors concluded that a stock dividend and stock split should be issued by the firm if their prospects are favorable and the price of the stock is beyond its optimal trading range. However, they did not analyze the optimum timing of the issuance of stock dividends.

Ross et al. (2005) examined the advantages and disadvantages of stock dividends, stock splits, and dividend declaration timing. A stock dividend or stock split increases a shareholder's number of shares while keeping their shareholding percentage the same. The firm does not pay cash to the shareholder in either of the scenarios above. The authors believe that the value of stock splits and stock dividends have no effect on firm value, neither dividends enhance firm value nor diminish the firm value. Because the overall earnings of the company and the percentage of shares owned by each owner remain unchanged, the firm's value will not improve. On the other hand, the stock price would usually increase with the announcement of a new or increased dividend. However, firms have to bear the transactions cost of issuing stock dividends or stock splits.

Generally, firms split their shares because they believe that a low stock price would attract more individual investors and increase the company's liquidity. The authors also analyzed the case of Apple Computer (Apple) to illustrate the reason and timing of the dividend payments. Apple was incorporated in 1976 and was listed in 1980. In 1987, it declared cash dividends and a stock split. The decision to pay dividends was to signal to the stock market about its potential growth and positive Net Present Value projects that enabled it to penetrate the computer market. The authors also show that Apple's dividend policy is more stable than its earning policy and further add that this is typical of the dividend policy of most firms. Most firms maintain a stable dividend policy despite their earnings volatility. However, if the firms suffer huge losses it would ultimately slash dividends. In the case of Apple, it maintained a stable dividend policy from 1987 to 1995 and completely omitted its dividend in 1996 when it was in the red. In conclusion, the authors should have given more reasons other than positive signals to the stock market in respect of the declaration of dividends by public companies.

Rankine and Stice (1997) examined how the stock market reacted to different accounting procedures for stock splits and dividends. The distinction between a stock dividend and a stock split, according to the authors, is that a stock split lowers the par value of the shares, but a stock dividend is a transfer of retained earnings to equity capital. They found that the market reacts favorably to the distribution of stock dividends as opposed to stock splits. When compared to stock splits, the announcement of stock dividends is associated with favorable future earnings growth. Because the market believes that the company's private information regarding future earnings is more favorable than present market expectations, this is the case.

Investors also believe that declaring stock dividends will result in the declaration of cash dividends or an increase in the amount of cash dividends paid. When a stock dividend is unexpected and perceived as a bonus, investors respond favorably. As a result, many companies now disclose stock splits as stock dividends, signaling to managers that the company is doing well.

2.2. Relationship Between Aggregate Dividend Behaviour and Permanent Earnings Hypothesis

Dividend increases may reflect the company's long-term profitability prospects, while dividend cuts would indicate reduced future earnings. Dividends are partially adjusted to reflect the target change in earnings, and these adjustments are based on a target payout ratio. Permanent earnings are described as a company's long-term, sustainable earnings. Managers revise dividends in response to permanent earnings changes. The percentage of dividends paid, on the other hand, is greater than the percentage change in permanent earnings behavior. This could be because management is overconfident when it comes to announcing dividends.

Companies adjust their dividend rates in accordance with their dividend policy. To counteract dividend reversals, management employs a partial adjustment policy, and dividends are not adjusted to permanent earnings changes until later. These findings are in line with the corporate earnings theory, which claims that company executives will only increase dividends if earnings improve permanently. Dividend policy is influenced by a goal payout ratio and the speed with which it adjusts to a target dividend change. Conservative companies would have a low-speed adjustment rate whilst a less conservative company has a high-speed adjustment rate of paying dividends.

2.3. Relevance of Dividend Policy

Rosiatimah (2002) analyzes the relevance of dividend policy. She defines dividend policy as the size and pattern of cash and stock distribution to shareholders over a period of time. Researchers have proposed many different theories

about factors that influence a firm's dividend policy. The most significant of these theories involve agency costs, asymmetric information (signaling), residual, taxes, and behavioral explanations. In the residual theory of dividend payments, firms would pay a balance of dividends out of the corporate profits. However, dividend payments are not as variable as residual profit. In the agency cost theory, the model assumes that dividend payments are an attempt to minimize the agency conflict between shareholders and managers.

The stakeholder theory advocates that focused firms tend to have lower dividend payout ratios while larger firms tend to have higher payout ratios than smaller firms. The dividend signaling model assumes that dividends are needed to convey positive information to poorly informed shareholders in capital markets. It conveys that management has confidence in the firm's profitability for investment projects and dividend payouts (Lease et al., 2000). In the dividend school hypothesis, there were three schools of thought. Investors in tax-adjusted models want and receive higher projected returns on dividend-paying stocks. The key rationale for dividend payment in the dividend signaling model is asymmetric information between the company and shareholders. Meanwhile, according to the agency cost theory, companies use a dividend policy to align the interests of shareholders and executives. Furthermore, dividend distributions may reduce the amount of money available for consumption by corporate executives, resulting in lower agency expenses.

Dividend policy is also affected by regulatory constraints, investment magnitude, debt, and firm size. Managers only decrease dividends in the event of absolute necessity. All theoretical models are incomplete due to a misunderstanding of the nature of dividend pay-outs. The lack of a significant difference between high-tax-bracket and low-tax-bracket individuals' portfolios does not prove the importance of taxes in determining corporation dividend policy. Dividends can convey information, but they don't explain why companies pay them. Models of dividend signaling and agency costs are both ambiguous. Dividends will continue to be paid due to long-standing business practices. Even during a company's turbulent era, managers are hesitant to limit dividend pay-outs. Furthermore, dividends are only increased if a company's management believes that the higher levels can be sustained. Current models of corporate dividend policy mostly ignore behavioral and socioeconomic influences on managerial and shareholder activities.

Travlos et al. (2001) analyzed the changes in shareholder wealth as a result of dividend policy changes in the share markets of Cyprus. The purpose of this article is to evaluate the role of cash and stock dividends in emerging stock markets. Firms pay stock dividends to signal information and keep the stock in the appropriate trading range. According to an academic study in the United States of America, stock price responses to stock dividend and stock split announcements are positive. Stock dividends are regarded as costly signals that send management's positive news about the firm's future prospects, which investors may take as good news.

Stock dividends and stock split also help to align prices to an appropriate trading range. This makes it possible for small investors to purchase the company's stock. Furthermore, companies cut their trading prices to increase liquidity, allowing more investors to purchase their stock. As a result, stock dividends and stock splits can achieve the best possible market price for a company's stock. According to the findings, organizations with a large post-event profits change will see higher positive returns when stock dividends are declared. This is based on the stock dividend signaling idea. The authors also argued that given different market microstructures, tax regimes, and regulation environments, corporate dividend distribution policies in emerging nations will differ. The writers did not, however, suggest a specific and ideal dividend payout policy that a company could pursue.

2.4. Signalling of Stock Dividends and Stock Splits

Brook et al. (1998) analyzed the relationship between the issuance of dividends and the increase in future cash flow. The authors began their article by outlining numerous hypotheses about why companies pay dividends. Firms raise dividends prior to a permanent increase in earnings, according to dividend signaling models. In addition, most companies have a target pay-out ratio to meet their dividend obligations. Based on their findings, the authors noted that firms that are going to have large future cash flow increases would increase their dividends before the realization of the cash flows. These firms would also have a positive abnormal return compared with the firms that do not pay dividends. Firms that are going to experience a temporary increase in cash flow would not increase their dividend rate until the increase in temporary cash flows is realized. The author's findings show that the reason for the payments of dividends is consistent with the dividend signaling hypothesis. It shows that the company is experiencing a future cash flow increase and a positive return on its stock. However, the findings do not show that an increase in dividend payments would signal future profitability.

Ikenberry et al. (1996) analyzed the relationship between the signaling of stock splits and the current value of the firm. Managers declare stock splits to convey favorable private information about the current value of the firm. In addition, share splits realign the share prices to an optimal trading range subject to the future performance of the firm. The authors examined a sample of 1,275 splits announced by the New York Stock Exchange (NYSE) and American

Stock Exchange (ASE) firms between 1975 and 1990. Splits generally occur because the shares are traded at a high price.

Before a stock split occurs, it was noted that 80% of the shares of the firms were traded at a price above their share price level. After the share split, the prices were lower than in the pre-split period. This is consistent with the theory that splits are typically used to realign the prices to an optimal trading range (Le et al., 2020). The results also show that the market reactions are greater for small firms, the low book-to-market firms (glamour stocks), and firms splitting their shares to lower prices. In addition, the results also found that the markets initially under-react to the share split exercise. Firms that split their shares enjoy significantly favorable long-run performance after the announcement. In general, splitting firms enjoy an access return of 7.93 percent in the first year after the split and 12.15 percent three years after the split. This article analyzed the relationship of the stock splits with the current value of the firm and the effects of the stock split on the share value of the firm. However, no analysis was done to prove the same theory for stock dividends.

3. Research Methodology

This paper analyzes the shares of Carlsberg Brewery Malaysia Berhad (Carlsberg). (A company listed on the Main Board of Bursa Malaysia Berhad in the consumer products sector).

The information and data of the research project were collected from various sources of secondary data. Sources of secondary data include annual reports from 1988 to 2004 of Carlsberg, journal articles published in magazines, and downloaded from the Internet Websites including Emerald, Proquest, and Google. Other references were also made on the research topic from various chapters of relevant corporate finance textbooks.

The research framework is developed in Figure 1 as follows.

4. Results and Discussion

The principal activities of Carlsberg are the production of beer, stout, shandy, and non-alcoholic beverages. The company is quite regular in paying cash and stock dividends to its shareholders.

Tables 1 and 2 below shows the issuance of rights and bonus shares from incorporation until 2004. The issuance of bonus shares is not on a yearly basis. This is consistent as per the literature survey that companies do not issue bonus shares every year. Bonus shares are treated as supplementary to cash dividends.

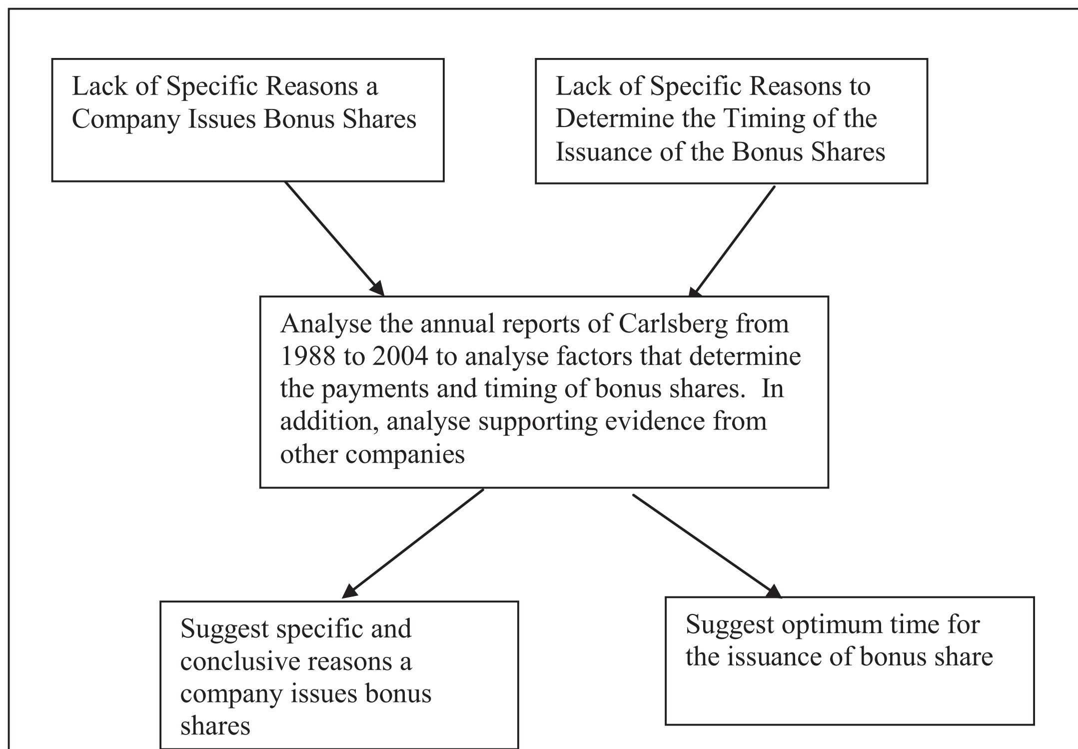

Figure 1: Research Framework

Table 1: Issuance of Rights and Bonus Issue from Incorporation Until 2004

Year	Particulars
1971	Initial subscription
1973	Rights issue : 1 for 2
1978	Bonus issue : 1 for 2
1981	Bonus issue : 1 for 2
1988	Bonus issue : 1 for 3
1990	Bonus issue : 1 for 2
1992	Bonus issue : 1 for 3
1994	Bonus issue : 1 for 4
1997	Bonus issue : 1 for 2

Table 2 shows the cash dividend payment history from 1977 to 2004. Based on the table below, we can analyze that the company has a stable cash dividend policy. The gross dividend rate for cash dividends increased from 20% to 105%.

Table 3 shows the share price of Carlsberg from 1988 to 2004. Based on the annual reports available at the Bursa Malaysia Berhad library, information could only be obtained for the share price of Carlsberg from 1988 onwards.

Table 4 analyses the comparison of the share price the year preceding the issuance of bonus shares and the year the bonus shares were issued. Based on Figure 5, we note that the share price of Carlsberg has increased from the year preceding the announcement of bonus shares to the year of issuance of bonus shares.

Table 5 analyses the percentage of payment of cash dividends the year preceding the issuance of bonus shares and the year of issuance of bonus shares. Based on the table below, there is evidence to show that the company increased its percentage of gross cash dividends on the year it issued bonus shares for the years 1978, 1990, and 1997. However, this does not happen every year the bonus shares were issued.

Based on the above tables, we can summarize as follows:

1. Companies do not issue bonus shares every year. Bonus shares are treated as a supplementary to cash dividends;
2. The share price of Carlsberg has increased from the year preceding the announcement of bonus shares to the year of issuance of bonus shares. This shows that the announcement of bonus shares would increase the price of the stock; and
3. There is evidence to show that the company increased its percentage of gross cash dividends on the year it issued bonus shares. However, this does not happen every year of the issuance of bonus shares.

Table 2: Cash Dividend Payment History from 1977 to 2004

Year	Total Dividend (‘000)	Gross Dividend Rate (%)
1977	1,440	20.0
1978	1,800	21.7
1979	2,786	25.8
1980	2,700	25.0
1981	3,240	25.0
1982	4,050	25.0
1983	4,590	25.0
1984	4,590	25.0
1985	4,590	25.0
1986	4,590	25.0
1987	4,590	25.0
1988	5,202	25.0
1989	6,630	25.0
1990	12,036	35.0
1991	16,065	35.0
1992	17,391	35.0
1993	21,624	35.0
1994	23,419	35.0
1995	28,050	35.0
1996	28,050	35.0
1997	46,920	50.0
1998	66,096	60.0
1999	115,584	105.0
2000	109,321	100.0
2001	81,991	75.0
2002	103,604	75.0
2003	103,859	75.0
2004	98,756	80.0

Further evidence also shows that the share price of the company increased once the announcement of bonus shares was made. Some of the examples are listed below:

1. Shares of Sungei Bagan Rubber Company jumped up RM7.50 on 4 April 2005 after the company announced the ex-date and entitlement date of its proposed 31-for-1 bonus issue;
2. Padiberas Nasional Bhd’s (Bernas) shares were RM0.15 higher on 9 April 2002 after it proposed a one-for-two bonus issue;

Table 3: Share Prices of Carlsberg from 1988 to 2004

Year	Share Price as of 31 December
1988	1.99
1989	2.93
1990	4.20
1991	4.00
1992	4.64
1993	6.51
1994	7.33
1995	7.93
1996	12.47
1997	12.50
1998	10.90
1999	11.70
2000	11.00
2001	10.80
2002	10.70
2003	11.00
2004	10.60

3. Riverview Rubber Estates Bhd share price surged in early morning trade on 21 December 2001 after it proposed a five-for-one bonus issue. Its share price increased by RM2.50; and
4. Kluang Rubber Company (Malaya) Bhd's share price increased by RM18.50 after it proposed a 29-for-one bonus issue.

The market views the issuance of stock dividends as a signal from the management of the potential favorable growth in the market. If the market is symmetric, the managers, shareholders, bankers, and others have the same information about the firm. Information asymmetric exists when one group has superior information about the firm's current situation and future prospects. Most of the time, managers possess superior information about their companies. The market believes that management has private information about future prospects and chooses dividends to signal that favorable information. Firms expecting higher future operating cash flows optimally pay higher dividends. Dividends are deemed to be the most efficient way of communicating inside information. Mature firms use large payouts as their primary signal and the announcement of dividend increases would cause larger price increases than growth firms. When the

Table 4: Comparison of The Share Price for the Preceding Year and the Year the Bonus Shares were Issued

Year Preceding Issuance of Bonus Shares	Price of Stock the Year Preceding Issuance Of Bonus Shares (As of 31 December)	Year Bonus Shares Issued	Price of Stock in the Current Year of Issuance of Bonus Shares (As of 31 December)
1989	2.93	1990	4.20
1991	4.00	1992	4.64
1993	6.51	1994	7.33
1996	12.47	1997	12.50

Table 5: Comparison of the Percentage of Payment of Cash Dividends the Year Preceding the Issuance of Bonus Shares and the Year of Issuance of Bonus Shares

Year Preceding Issuance of Bonus Shares	Percentage of Cash Dividend Paid Out (Gross)	Year Bonus Shares Issued	Percentage of Cash Dividends Paid Out
1977	20.0%	1978	21.7%
1980	25.0%	1981	25.0%
1987	25.0%	1988	25.0%
1989	25.0%	1990	35.0%
1991	35.0%	1992	35.0%
1993	35.0%	1994	35.0%
1996	35.0%	1997	50.0%

share price is undervalued, managers may be able to use dividends to establish market value in line with private information. However, as the payment of dividends has costs to the management, management has to evaluate the importance and urgency of establishing an appropriate market value. In addition, the market also reacts more strongly to regular dividend increases than special or designated dividends. Temporary cash flow increases are better distributed as special or designated dividends whilst regular dividends are issued in the event of a permanent cash flow increase.

Based on the findings, we can conclude that a declaration of bonus shares would increase the stock price which in turn would increase liquidity. Therefore, the specific reasons a firm issues bonus shares are to improve the company's liquidity and convey private positive information to its shareholders. Consequently, the most optimum time to issue bonus shares is when there is evidence of asymmetric information as investors would react positively to positive private information.

5. Conclusion and Limitations

The declaration of bonus shares remains a puzzle as no stable and concrete policy exists. Many firms declare bonus shares to convey positive signals about their future prospects and also improve the liquidity of their shares. Managers must design dividend policies around market imperfections, i.e. taxes, agency costs, and asymmetric information that significantly affect their firms and shareholders. Taxes and agency costs would affect the cash dividends policy while the existence of asymmetric information would affect bonus shares and cash dividend policy. Consequently, dividend policies would differ significantly from one firm to the other firm based on the weights each of the imperfections have on the firm and shareholders.

This research compared the prices of Carlsberg on 31 December, i.e. at the end of the respective years preceding the issuance of bonus shares and the year the bonus shares were issued. Future research should compare the prices on the day prior to the bonus share ex-dividend date and the date on and after the ex-dividend date. In addition, future research should also determine whether the declaration of the stock dividend would align the share price to its optimal trading range.

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