About stock splits

Stock split is the process of splitting shares with high face value into shares of a lower face value. It's like getting an Rs.20 note changed for two Rs.10 notes. The value changes of neither note nor splitted stock.
Investors must have read a lot on stock splits in newspapers of late. There have been several stock splits in recent times. Not to mention the spiralling stock prices due to stock splits. Ever wondered what actually does a stock split do? A faintly similar thing is bonus. How does that work?

In theory, a stock split shouldn't affect market capitalisation
Let us take the stock split of Infosys as an example. The company split its share into two. If the pre-split price of a share is Rs10, and the stock is split two for one, then, theoretically speaking, the price of the new (split) share should be Rs5. That's because the company's net assets do not increase, only the amount of its outstanding shares goes up. But life is vastly more complicated than theory. In the Infosys' stock split, the market was expecting five shares for one; the two-for-one ratio disappointed it and the stock plummeted after the split was declared.

Theoretically, a stock split is a non-event. The fraction of the company that each share represents is reduced, but each stockholder is given enough shares so that his or her total fraction of the company owned, remains the same. The split should not change market capitalisation.

But it often improves sentiment for the stock
In practice, however, market cap does change. A split often drives the new price per share up, as more of the investing public is attracted by the lower price. A company might split when it feels its share's price has risen beyond what an individual investor is willing to pay, especially when the shares are bought and sold in marketable lots. Even when the shares are traded in the demat mode, where even one share may be traded, the price may be high enough to discourage small investors. A shining example is Infosys again. The stock was trading at almost Rs10,000 prior to its split. (Of course, it has almost doubled since then, and is quoting at the same level post-split! But that is a different story).

It attracts small investors and increases liquidity
Another reason frequently offered for a stock split is that it increases liquidity. Because the number of shares increases, the amount that investors are willing to buy or sell also goes up. For instance, an investor may be willing to buy one share of Rs5000, but may not venture if the share price is Rs10,000. Companies sometimes want to attract individuals to stabilise the price, as institutional investors

buy and sell more often than individuals. That's yet another reason for a split.

What about bonus?
Bonuses have a long history in India. A bonus is nothing but capitalisation of the issuing company's free reserves. If a company has a capital of Rs100, and reserves of Rs100, it can issue bonus shares of Rs100. In its balance sheet, the company's capital will then (post-bonus) be Rs200, while reserves will be nil. The net worth of the company will not have changed in any way.

So, here too, the price of the single share should diminish, depending upon the bonus ratio. Again, in practice, a bonus issue is a way of the company to reward its shareholders. It is also a sign that the company is healthy. That's because while nothing may have changed for the shareholder, the company has the responsibility of servicing the new shares.

Make use of stock splits

Effect of stock split
A stock split increases the number of shares in a public company. The price is adjusted such that the market capitalization of the company almost remains same.
Why stock split is done?

1) Companies usually split their stock when they think the price of their stock exceeds the amount smaller investors would be willing to pay. "It is aimed at making the stock more affordable and liquid from retail investors' point of view."
2) Generally, there are more buyers and sellers of shares trading at Rs.100 than say, Rs.400, as retail shareholders may find low-price stocks to be better bargains. Stock splits are usually initiated after a huge run-up in the share. This run-up may be linked to the performance of the stock.
3) The company may declare such splits in different ratios like 2-for-1, 3-for-1, 3-for-2, or like 4-for-1. Some companies may go to the extent of declaring a 10 for 1 split, as power services company GVK Power did recently.
   For example, XYZ Company is trading at Rs.250 and you hold 100 shares. Hence, the total value of your holding is Rs.25, 000 (250x100).
4) If this company declares a 2-for-1 stock split, your 100 shares become 200 and the share price is adjusted to Rs.125.
   The value of your investment still remains the same (this time, 125x200). And if the company had 10 lakh outstanding
   shares before the split, it will now have 20 lakh outstanding shares after this split, keeping the market cap unchanged.
5) Sometimes, companies may choose to club stock split issue with bonus shares. Bangalore based jewellery
   manufacturer Rajesh Exports recently declared a 2-for-1 stock split along with a bonus offer

of two shares for each
share held.
6) This means that each share becomes two, post-split. Now, for these two shares, shareholders will get four additional
shares as bonus. Thus, one share translates into six after stock split and bonus issue.
"To ensure increased liquidity for existing shareholders and easy entry point for new shareholders, the decision was
made to split the share."

Benefit to shareholders after stock split and bonus issue.
Due to stock split, the high priced stocks will be available at lower rates. The retailer or small investors can easily afford to buy stocks of low price. There is also a probability that after stock split; the stock price may go up as more investors may rush to buy stocks at lower rates.

When to buy stock split stock?
a) If you wish to get benefited from stock split then you have to buy those stocks before record date.
b) A company announces record date.
c) If you buy those stocks before record date then you will be eligible for stock split.
d) If you are not interested to buy stock after stock split where the stocks are available at lower rates.