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DO STOCK SPLITS INFLUENCE SHARE PRICES? INSIGHTS FROM THE INDIAN STOCK MARKET

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ABSTRACT

A stock split is a corporate action that increases the number of a company's outstanding shares by dividing existing shares into multiple new shares. However, the stock's market capitalization remains unchanged. Companies typically implement stock splits when their share prices become too high, making it difficult for investors to buy shares. This study examines the market reaction to stock split announcements of S&P CNX 500 stocks listed on the National Stock Exchange (NSE) using the Event Study Methodology. A sample of 74 stock split announcements from 2019 to 2024 is analyzed. The significance of Average Abnormal Returns (AARs) and Cumulative Average Abnormal Returns (CAARs) is tested using a One-Sample 't' test. The findings indicate that stock split announcements generate significant positive returns.

KEYWORDS: Average Abnormal Returns (AARs); Cumulative Average Abnormal Returns (CAARs); Stock Splits; Event Study

INTRODUCTION

A stock split is a corporate action that increases the number of outstanding shares by proportionally reducing the par value of each share. While a stock split alters the share count and par value, it does not impact shareholders' total equity. The key difference between a stock split and a bonus issue lies in their nature and effect on company reserves. A bonus issue involves distributing additional free shares to existing shareholders, reducing the company's reserves as they are transferred to paid-up capital. In contrast, a stock split only increases the number of shares by dividing their face value, without affecting the equity balance.

Several theories explain why companies choose to split their stock, including the **optimal price range hypothesis, signaling hypothesis,** and **neglected firm hypothesis**.

Optimal Price Range Hypothesis

High-priced stocks are often considered less liquid due to psychological factors and higher transaction

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costs. When stock prices rise beyond an optimal level, companies execute stock splits to lower the price per share, making trading more accessible and improving liquidity. This aligns with the **optimal price range hypothesis**, which suggests that stocks trade most efficiently within a specific price range. Copeland (1979) argued that stock splits adjust prices to this optimal range, increasing demand. Similarly, Baker & Powell (1993) found that enhancing liquidity was a primary motivation for stock splits.

Signaling Hypothesis

According to the **signaling hypothesis**, stock splits serve as a means for managers to convey positive information to investors. Brennan & Copeland (1988) suggested that executives only initiate stock splits when they are confident that share prices will remain stable or increase in the future. If they expect prices to decline, they would avoid a split, as trading lower-priced stocks often incurs higher costs.

By leveraging these strategic considerations, companies use stock splits as a tool to optimize share liquidity, attract investors, and signal confidence in future performance.

Review of Literature

Several studies have explored the impact of stock split announcements on share prices, highlighting varying market reactions across different regions and time periods.

Stock Splits and Market Reactions

Asquith et al. (1989) analyzed 121 firms listed on the American Stock Exchange to determine whether stock splits convey information about earnings. Their findings showed a significant positive relationship between earnings growth and stock splits, with two-day excess returns of 3.7% surrounding the stock split announcement. Similarly, Dolley (1933) examined 95 stock splits from 1921 to 1931 and found that prices increased in 57 cases, declined in 26, and remained unchanged in 12 instances.

Fama et al. (1969) investigated the impact of stock splits on 940 firms listed on the New York Stock Exchange. They observed the largest positive returns three to four months before the split but found no further systematic increase in cumulative abnormal returns post-split. Their study supported the **semi-strong form of market efficiency**, indicating that stock prices adjust rapidly to new information.

Crawford & Franz (2001) examined 1,483 stock dividend and stock split events between 1983 and 1993. They found a positive stock market response to stock distribution announcements and a negative correlation between market reaction and pre-split stock prices.

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Stock Splits in Emerging Markets

Hua & Ramesh (2013) analyzed stock price responses to stock split announcements on the **Colombo Stock Exchange (CSE)** from 2009 to 2012 using event study methodology. Their findings confirmed a **positive market reaction** to stock split announcements. Similarly, Jaduda & Caroline (2010) studied stock splits at the **Nairobi Stock Exchange** (2002–2008) and observed an increase in trading volumes around split events, with cumulative abnormal returns indicating a **positive market response**.

In the Indian stock market, multiple studies have examined the impact of stock split announcements. Raja et al. (2009) studied the efficiency of the Indian stock market with respect to stock split announcements by **IT companies (2000–2007)** and found significant market reactions. Mishra (2007) analyzed 180 stock splits in India (1999–2005) and found **negative cumulative abnormal returns** after the split. Ray (2011) examined **bonus issues and stock splits** (1996–2008) and found that while stock splits led to a **significant change in liquidity**, bonus issues did not elicit strong market reactions.

Pradhan et al. (2018) studied the impact of stock splits on **S&P BSE 500** companies and found that stock splits influenced share prices and increased trading volumes. However, Kumari & Pushpender (2019) analyzed **bonus issue announcements** (2014–2018) and found that the **Indian stock market did not react significantly** to such announcements.

Stock Split Motivations and Industry Effects

Lakonishok & Lev (1987) investigated firms' motivations for stock splits and dividends (1963–1982). They found that companies implementing stock splits exhibited higher earnings and dividend growth post-split. Their findings suggested that stock splits were primarily used to **bring stock prices back to an optimal range** after a period of rapid growth.

Masse et al. (1997) analyzed the market reaction to **Canadian stock splits, reverse splits, and stock dividends** (1975–1994) and found positive market responses to all three events. Wulff (2002) examined **German stock splits (1994–1996)** and observed **significant positive abnormal returns** around both the announcement and execution dates.

Tawatnuntachai & D'Melio (2002) studied the spillover effects of stock splits on **non-splitting firms within the same industry** (1986–1995). Their findings showed that **shareholders of non-splitting firms experienced a small but significant increase in equity value**, suggesting that stock split announcements positively influenced industry counterparts.

Stock Splits as a Signaling Mechanism

According to the **signaling hypothesis**, stock splits act as an **indicator of managerial confidence in future performance**. Brennan & Copeland (1988) argued that executives initiate stock splits when

they believe share prices will increase or remain stable. Rajesh Khurana & Warne (2016) analyzed **bonus issue announcements in NSE 100 stocks** and found **significant positive abnormal returns in the pre-event window**, supporting the signaling effect.

Kavita Chavali & Shemeem (2011) found that stock buybacks also generated **positive abnormal returns**, reinforcing the idea that corporate actions, including stock splits, influence investor sentiment.

Statement of the Problem

The literature suggests that stock splits generally result in **positive abnormal returns** and **increased liquidity**, though market reactions vary based on economic conditions and market efficiency levels. Studies in developed markets, such as the **U.S. and Germany**, indicate that stock splits align with **semi-strong market efficiency**. Meanwhile, emerging markets, including **India, Kenya, and Sri Lanka**, demonstrate strong investor reactions to stock split announcements, often leading to increased trading volumes. The above studies show a mix of contradictory evidences to stock split announcement. In this context the researcher is motivated to study the Indian stock market on impact of stock split announcements on share prices for the period 2019-2024.

Objectives and Hypotheses

Objectives

1. To analyze the stock market reaction to stock split announcements of **S&P CNX 500** companies.
2. To assess the presence of significant abnormal returns (positive or negative) associated with stock split announcements.

Hypotheses

- **H1:** There are significant **Average Abnormal Returns (AARs)** around stock split announcements in both the pre-event and post-event windows.
- **H2:** There are significant **Cumulative Average Abnormal Returns (CAARs)** around stock split announcements in both the pre-event and post-event windows.

Sample and Data

Sample

This study examines stock split announcements made by companies listed in the **CNX 500 index of the NSE** during the period **2019–2024**. To ensure accuracy, stocks with **price-sensitive information, data inconsistencies, or confounding events** within the event window (-30 to +30 days) were

excluded. After applying these criteria, a final sample of **74 stock split announcements** was selected for analysis.

Data

The study relies on three key datasets:

1. **Stock Split Announcements:** Information on stock split announcements was collected from the **Capitaline database**, including the announcement dates.
2. **Stock Prices:** Daily closing prices of the selected stocks were obtained from the **NSE**.
3. **Market Index Data:** Daily closing prices of the **S&P CNX 500 index**, compiled and published by **NSE**, were sourced from the official website (www.nseindia.com).

Statistical Tools and Techniques

This study is **descriptive in nature** and relies on **secondary data**. The **Event Study Methodology** is employed to analyze the data, assessing whether abnormal returns occur around stock split announcements. The presence of an **announcement effect** is confirmed only if abnormal returns are statistically significant.

Event Study Methodology

The **market model** assumes a **linear relationship** between a stock's return and the return of the market portfolio. In this study, the **NSE S&P CNX 500** index is used as the **benchmark index**.

To estimate expected returns, stock returns are regressed against **NSE S&P CNX 500** returns over a **360-day estimation window**, ending **30 trading days before the announcement date**. The **α (alpha) and β (beta) coefficients** derived from this regression are then used to compute expected abnormal returns for the **event window** (from **-30 to +30 trading days** relative to the announcement date).

Methodology: Two-Stage Approach

This study employs a **two-stage approach** to analyze stock split announcements:

1. **Estimation Stage:**
   - Parameters such as **alpha (α) and beta (β)** are estimated using historical stock returns, market index returns, and expected stock returns based on the **market model**.
2. **Calculation Stage:**
   - The estimated parameters (**α and β**) are applied to compute **abnormal returns (ARs)** around the stock split announcement date.

Event Window Definition

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- The **stock split announcement date** is defined as **Day 0 (Source Day)**.
- If **Day 0 falls on a non-trading day**, the next trading day is considered as the **event day**.
- The **pre-announcement period** spans **30 trading days before the announcement** (**Days -30 to -1**).
- The **post-announcement period** covers **30 trading days after the announcement** (**Days +1 to +30**).
- In total, the **event window consists of 61 trading days**, including **Day 0**.

To analyze market reaction, **Abnormal Returns (ARs)** are computed and then averaged across securities to derive **Average Abnormal Returns (AARs)**. AARs are further **cumulated** to determine **Cumulative Average Abnormal Returns (CAARs)**.

For this study, the **expected returns** on each security are estimated using a **simplified regression model**, which considers actual market returns.

$$ExpectedReturn = E(Rit) = \alpha i + \beta i Rmt$$

Where,

E (Rit) = Expected return on security 'i' during time period 't'

αi= Intercept of a straight line or alpha coefficient of i^{th} security

βi= Slope of a straight line or beta coefficient of i^{th} security

Rmt= Expected return on index (S&P CNX 500 index in this study) during period't'

Following are the models used for calculations:

Abnormal returns (ARs)

$$ARit = Rit - E(Rit)$$

Where,

Rit= Actual returns

E (Rit) = Expected return on Security

Average abnormal returns (AARs)

$$AARit = \frac{\sum_{i=1}^{N} ARit}{N}$$

Where,

i = Number of securities in the study

N = Total number of securities in the portfolio

t = Days surrounding the event day

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Cumulative Average Abnormal Returns (CAAR)

$$CAARt = \sum_{t=-30}^{k} AARit$$

Where,

t = -30,…0,…+30

t Value for AAR

$$t(AAR) = \frac{AAR}{\frac{\sigma}{\sqrt{n}}}$$

Where,

σ = Standard deviation n = Number of records

Data Analysis and Interpretation

This study examines the impact of **stock split announcements** on stock prices using a sample of **74 stock split announcements** from companies listed in the **S&P CNX 500 index** during the period **January 2019 to December 2024**.

Hypotheses

To assess the effect of stock split announcements on stock prices, the following hypotheses were tested:

- **H1:** There are significant **Average Abnormal Returns (AARs)** around stock split announcements in the **pre-event and post-event window**.
- **H2:** There are significant **Cumulative Average Abnormal Returns (CAARs)** around stock split announcements in the **pre-event and post-event window**.

Key Findings

Table 1 presents the **AAR** and **CAAR** measured using the **Market Model**, along with corresponding **t-values** for the event period (**Day -30 to Day +30**).

- During the **pre-announcement period** (**Day -30 to Day -1**), **AAR was positive for 27 days** and **negative for only 3 days**.
- On the **announcement day (Day 0)**, the **AAR was 0.72%**, which is **positive and statistically significant at the 5% level**.

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- These results indicate that the announcement of stock splits conveyed **positive news to the market**, leading to a **significant increase in stock prices**.

The analysis reveals that **AAR is positive and significant** on the following days:

- **At 1% significance level:** Days **-30, -21, -14**
- **At 5% significance level:** Days **-22, -13, -5, -2**
- **At 10% significance level:** Days **-11, -8, -4**

The presence of significant AARs on **multiple days before the event** (**-30, -22, -21, -14, -13, -11, -8, -5, -4, and -2**) suggests that **information about the stock split may have leaked prior to the official announcement**.

In the **post-event window**, AAR is **positive for 16 days** and **negative for 14 days**. Notably:

- **AAR is positive and significant on Day +11 at the 10% level.**
- **AAR is negative and significant on Day +22 at the 10% level.**

Table 1 AAR and CAAR around the Stock Splits Announcements

(Returns in Percentage)

Days	AAR	CAAR	t (AAR)	Sig. (2-tailed)	Days	AAR	CAAR	t (AAR)	Sig. (2-tailed)
-30	1.15109	1.15109	2.999***	0.004	0	0.72536	13.24772	2.325**	0.023
-29	0.41334	1.56443	1.035	0.304	1	0.35044	13.59816	0.977	0.332
-28	0.30763	1.87206	1.133	0.261	2	-0.31015	13.28801	-0.635	0.527
-27	-0.23182	1.64024	-0.880	0.382	3	0.25302	13.54103	0.926	0.357
-26	0.29878	1.93902	0.950	0.345	4	0.29649	13.83752	0.742	0.461
-25	0.08000	2.01901	0.298	0.766	5	-0.07876	13.75876	-0.235	0.815
-24	0.04615	2.06516	0.179	0.859	6	-	13.4840	-1.034	0.305

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						0.27467	9		
-23	0.45380	2.51896	1.445	0.153	7	0.06061	13.54470	0.203	0.839
-22	0.69694	3.21590	2.080**	0.041	8	-0.10820	13.43650	-0.346	0.731
-21	0.99855	4.21445	3.204***	0.002	9	0.23701	13.67351	0.812	0.420
-20	0.38614	4.60058	1.281	0.204	10	-0.95954	12.71397	-0.855	0.395
-19	0.40113	5.00171	1.598	0.114	11	0.41782	13.13179	1.673*	0.099
-18	0.24581	5.24752	0.897	0.373	12	0.15567	13.28746	0.589	0.558
-17	-0.15018	5.09734	-0.574	0.567	13	-0.09205	13.19541	-0.351	0.726
-16	0.21495	5.31229	0.855	0.396	14	-0.04529	13.15012	-0.185	0.854
-15	0.27027	5.58256	0.811	0.420	15	0.06806	13.21818	0.273	0.786
-14	0.74160	6.32416	2.663***	0.010	16	-0.85379	12.36439	-0.752	0.455
-13	1.02859	7.35275	2.195**	0.031	17	-1.62718	10.73721	-1.194	0.237
-12	0.30040	7.65315	0.945	0.348	18	0.01762	10.75483	0.073	0.942
-11	0.69035	8.34350	1.733*	0.087	19	0.08041	10.83524	0.292	0.771
-10	0.46352	8.80702	1.415	0.161	20	-0.98466	9.85057	-0.881	0.381
-9	0.29249	9.09952	1.025	0.309	21	0.03350	9.88407	0.127	0.900
-8	0.59477	9.69428	1.772*	0.081	22	-0.47616	9.40791	-1.818*	0.073

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-7	-0.13552	9.55877	-0.410	0.683	23	-1.60186	7.80605	-1.164	0.248
-6	0.17212	9.73088	0.580	0.564	24	-0.43928	7.36677	-1.346	0.182
-5	0.55803	10.28892	2.025**	0.047	25	-0.80514	6.56162	-0.631	0.530
-4	0.73409	11.02300	1.964*	0.053	26	0.00001	6.56164	0.000	1.000
-3	0.41253	11.43554	0.984	0.328	27	0.37387	6.93550	1.521	0.133
-2	0.82755	12.26309	2.122**	0.037	28	0.12892	7.06442	0.529	0.598
-1	0.25927	12.52236	0.808	0.422	29	0.12210	7.18652	0.432	0.667
0	0.72536	13.24772	2.325**	0.023	30	0.07097	7.25749	0.244	0.808

*Significant at 10% level, ** Significant at 5% level, ***Significant at 1% level

The **positive and significant AARs in the pre-event period** indicate that **stock split announcements conveyed favorable information to the market**, leading to **an increase in stock prices before the official announcement**.

Thus, **H1 is accepted**, confirming that there are **significant AARs around stock split announcements**.

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Table 2 CAAR around Stock Splits Announcements for different Event Windows

(Returns in Percentage)

Event Window (in days)	CAAR	t(CAAR)	Sig. (2-tailed)	Event Window (in days)	CAAR	t(CAAR)	Sig. (2-tailed)
(-30 , 0)	13.24772	7.009***	0.000	(0 , +20)	-2.67179	-1.047	0.307
(-20, 0)	9.03327	6.567***	0.000	(0, +30)	-5.26487	-1.684	0.102
(-10, 0)	4.90422	5.182***	0.000	(-30, +30)	7.25749	1.693*	0.096
(-5, 0)	3.51684	6.590***	0.001	(-20, +20)	5.63612	1.684*	0.100
(-2 , 0)	1.81218	3.454*	0.075	(-10, +10)	4.37047	2.268**	0.035
(0 , +2)	0.76565	0.843	0.488	(-5, +5)	4.02788	3.504***	0.006
(0 , +5)	1.23640	1.402	0.220	(-2, +2)	1.85247	1.840	0.140
(0, +10)	0.19161	0.130	0.899	(-1, +1)	1.33507	3.120*	0.089

*Significant at 10% level, ** Significant at 5% level, ***Significant at 1% level

Table 2 presents a **consistent increase in CAAR** around stock split announcements within the event window. Notably:

- **CAAR is 1.15% on Day -30** and **rises to 13.24% on the event day (Day 0)**.
- **CAAR reaches its peak at 13.83% on Day +4**, indicating a strong **holding period return** around stock split announcements.

CAAR Significance across Different Event Windows

- **Pre-event windows:**
  - **Significant at 1% level:** (-30, 0), (-20, 0), (-10, 0), (-5, 0)
  - **Significant at 10% level:** (-2, 0)
- **Post-event and full-period windows:**
  - **Significant at 1% level:** (-5, +5) → Suggests a favorable reaction to stock splits.
  - **Significant at 5% level:** (-10, +10)
  - **Significant at 10% level:** (-30, +30) and (-20, +20)

The highest **CAAR of 13.24%** is observed in the **pre-event window (-30, 0) at 1% significance level**, reinforcing the positive market reaction before the announcement. In contrast, the **lowest CAAR**

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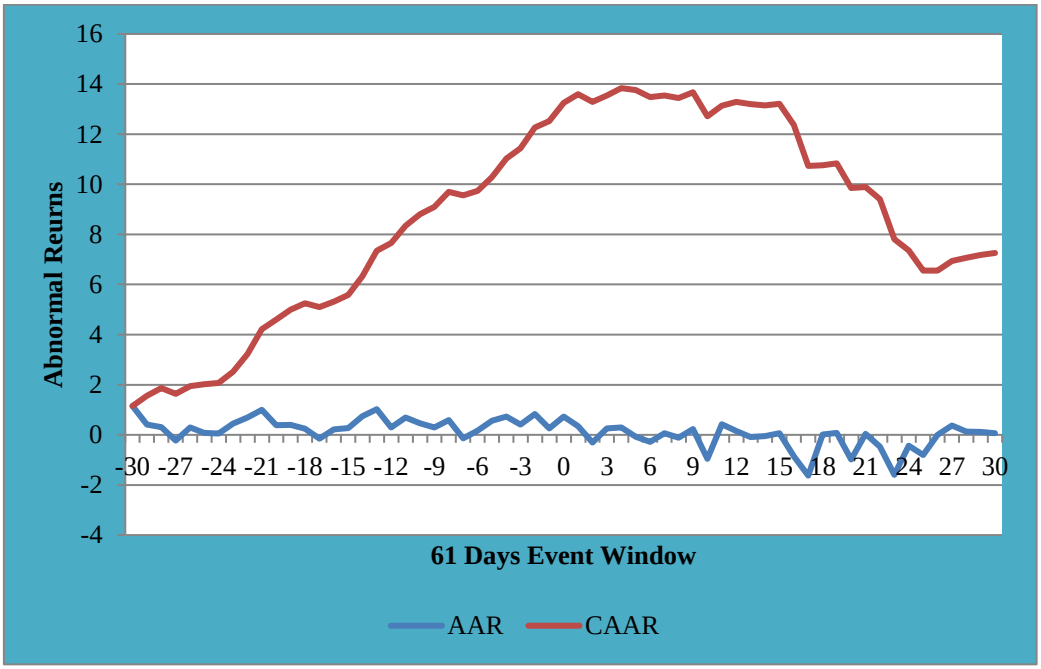
of -5.26% in the post-event window (0, +30) is not statistically significant, suggesting a limited long-term impact.

The results suggest that **investors benefit from stock split announcements**, as seen in **significant positive returns during the holding periods within the event window**. Therefore, **H2 is accepted**, confirming that **CAARs around stock split announcements are significant in both pre-event and post-event windows**.

These findings align with prior research, including **Fama et al. (1969), Grinblatt et al. (1984), Wulff (2002), Lakonishok & Lev (1987), Asquith et al. (1989), Masse et al. (1997), Tawatnuntachai & D'Melio (2002), Ray (2011), Rajesh Khurana & Warne (2016), and Subhendu Kumar Pradhan et al. (2018)**, which also report **significant positive market reactions to stock split announcements**.



CONCLUSION

The study finds that **AAR is positive and significant for 10 days in the pre-event window, one day in the post-event window, and on the event day**, indicating a strong market reaction to stock split announcements. Additionally, **CAAR shows a consistent positive trend throughout the event window**, with significant positive returns in the **pre-event window and around the announcement date**. This suggests that investors prefer stocks undergoing stock splits, likely due to the **signaling effect**, which implies that share prices have been increasing, necessitating a split, and may continue to rise due to **improved firm performance**. These findings align with the **Signaling Theory** (Brennan

& Copeland, 1988).

However, the study also observes **negative CAAR in the post-event windows (0, +20) and (0, +30)**. This can be attributed to the fact that **a stock split does not alter a company's net worth or market capitalization, even though the number of outstanding shares increases**. Companies often split their stocks to keep share prices within an **optimal trading range**, as suggested by the **Optimal Price Range Hypothesis** (Copeland, 1979). According to this theory, stocks trade most efficiently within a certain price range, ensuring better liquidity.

Financial experts believe that while stock splits **historically contribute to long-term value creation**, this is contingent on **proportionate fundamental growth**. In bullish market conditions, corporate actions like **stock splits and bonus issues** can enhance shareholder wealth. In the long run, stock splits can **increase market capitalization, enhance stock liquidity, and make share prices more accessible to retail investors—provided the company maintains strong fundamentals**.

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