BONUS SHARE ISSUES IN AUSTRALIA

by

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This article reports some findings of a research project concerning the reasons for, the attitudes of non-corporate shareholders towards, and the costs of making bonus issues in Australia. While the reasons given by the issuing companies indicate that most of these companies are aware of the nature and consequences of bonus issues, private investors appear to hold naive views of such issues. The costs of making bonus issues during the financial year 1980-81, as estimated by the respondent companies, ranged from $0.13 to $69.92 per shareholder; however, since the distribution was skewed, for 95 per cent of the respondents the estimated cost was less than $5.00 per shareholder.

INTRODUCTION

Bonus share issues are a familiar part of the stock market scene in Australia. While the terms 'bonus issue' and 'bonus shares' are widely used in this country, they are generally avoided in other countries where less misleading terms are used (e.g. 'capitalisation issue'[1], 'free scrip issue', 'stock dividend'). It is misleading to use the word 'bonus' in this context because usually the main effects of bonus share issues per se are simply to reclassify shareholders' funds and to increase the number of shares in issue (with a corresponding drop in share price), not to confer a bonus on the recipients.[2]

In order to gather information concerning the reasons for, attitudes of private investors towards, and the costs of making bonus issues in Australia, plus certain other relevant information, the authors surveyed the following: (a) all stock exchange listed companies which made at least one bonus issue to their ordinary shareholders in the financial year July 1, 1980 to June 30, 1981; (b) a sample of listed companies which did *not* make a bonus issue in the same period; and (c) a sample of non-corporate shareholders in companies which made a bonus issue in that period. This paper summarises some of our main findings.[3]

In respect of (a), 111 replies were received from the total of 150 listed companies which had made an issue in 1980-81, giving a response rate of 74.0 per cent. In respect of (b), 109 replies were received from a randomly-chosen sample of 150 companies (72.7 per cent). In respect of (c), 114 responses were obtained from a randomly-chosen sample of 160 non-corporate shareholders (71.3 per cent).

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The number of bonus issues made by companies in Australia as well as the proportion of share capital growth (book value) caused by such issues have increased considerably in recent years. In 1980, these issues accounted for 36.7 per cent, on average, of the growth in the book value of the share capital of all non-financial companies listed on Australian stock exchanges (including 68 unlisted companies), compared with 19.7 per cent in 1976.[4] In the financial year 1980-81, to which our survey relates, 150 (i.e. 15.4 per cent) of the 974 companies listed on Australian stock exchanges (285 mining and 689 non-mining companies) made at least one issue. Since some companies made more than one issue, the total number of issues was greater than 150.

Notwithstanding the popularity of bonus share issues in Australia, little research appears to have been done into the reasons for, investor attitudes towards, or the cost of these issues. Some research has been undertaken to ascertain whether bonus issues result in abnormal returns to shareholders in this country as well as in Britain, the United States and New Zealand.[5] The results suggest that bonus shares per se offer either an insignificant gain to shareholders or none at all, a finding which is consistent with the fact that such shares do not normally cause, or result from, a fundamental change in the company's affairs.

In Australia, the announcement of a bonus issue is often accompanied by a statement that the dividend per share will be maintained after the issue, which is another way of saying that total dividends will increase. Eighty-two per cent of all companies which made a bonus issue in Australia in the year 1980-81 simultaneously announced that the dividend per share would be maintained. The resultant increase in total dividends which is frequently linked with a bonus issue probably explains why so many investors appear to regard the issue itself as having value.[6] It is a simple matter for investors to overlook the fact that dividends can be increased without a bonus issue just as a bonus issue can be made without an increase in dividends. Where both occur together, the bonus issue should be seen merely as part of an information package which tells shareholders that total dividends are to be increased.

REASONS FOR BONUS ISSUES

Four possible reasons for making bonus issues (see Table 1) were specifically stated in the questionnaire which we sent to the 150 companies which made a bonus issue in the financial year 1980-81. The recipients were asked to rank these or other reasons in order of importance as they saw it. As can be seen from Table 1, most respondents gave the most important reason as being "to convey a favourable impression of future prospects to shareholders and/or the stock market as a whole". The percentage of respondents giving this reason as the most prominent (34.9 per cent) was well above that for the second reason (18.3 per cent) and only 22 per cent of the respondents considered it to be the least important.

The second most frequently given main reason was only marginally ahead of the third (17.5 per cent). The second indicates a desire to make the company's capital structure more realistic while the third suggests that high dividend rates[7] can embarrass a company by implying excessive profits.

TABLE 1

	Most Important Reason	Frequency
1.	To convey a favourable impression of future prospects to shareholders and/or the stock market as a whole	44 (34.9%)
2.	To increase the Company's issued capital by a transfer from Share Premium or other Reserve account so as to indicate that these reserves are represented by assets tied up in the business	23 (18.3%)
3.	To reduce the ratio: $\frac{\text{dividend per share}}{\text{par value per share}}$	22 (17.5%)
4.	To reduce share price to a more 'marketable' range	8 (6.4%)
5.	Various other reasons	29 (23.0%)
		126 (100.0%)

Note: Total frequency exceeds 111 because some of the respondent companies ranked more than one reason as being the most important.

The fourth most frequently given main reason (6.4 per cent) was well below the second and third. 'Odd lots' of shares do not make up a 'marketable parcel' and are more expensive to buy and realise less when sold. A reduction in share price, brought about for instance by a bonus issue, can enable more investors to buy a marketable parcel.[8] The reduction in a share's market price to a more marketable range was also ranked as the least important reason for a bonus issue by as many as 58 per cent of the respondents. This is probably at least partly explained by the availability of share-splitting or rights issues at a substantial discount on market price as alternative methods of reducing share price.

Thus most respondent companies did not justify bonus issues on the grounds that they were of direct value (i.e. bonuses) to shareholders. Justification was rather on the grounds that they enable management to achieve some other objective or set of objectives. While these other objectives might indirectly confer a benefit on shareholders, they do not represent the direct economic benefit which is implied by the word 'bonus'.

Nevertheless, the management of as many as 18 per cent of the companies surveyed believed that by issuing bonus shares they were providing a direct, tangible reward to shareholders. This is a disturbingly high proportion because it suggests that the management of these companies did not really understand the nature of bonus issues.

To illustrate, some of the reasons for making bonus issues given by this minority group as the main justification for their issues were: "our policy is that 'profits' from revaluation of properties belong to shareholders and not to a corporate raider"; "to provide capital growth benefits to shareholders"; "to pass on to shareholders the benefits of realized capital profits"; "to provide a broader base for shareholders to participate in profits and to increase their market worth"; "to provide a tax free dividend to shareholders"; "to protect shareholders' investment from inflation"; "to mark the 50th anniversary of the Group"; "to reward shareholders after valuing assets to their market value"; and "for benefit of shareholders".

Another 8 per cent of the respondents gave more plausible 'other'reasons as the main justification for their bonus issues, viz.: "to retain cash without shareholder dissatisfaction" (2.7 per cent); "to satisfy psychological needs of shareholders" (0.9 per cent); "to defend the company against a takeover bid" (1.8 per cent); and "to reduce asset backing per share" (2.7 per cent).

Of the 109 replies from the sample of 150 companies which did *not* make a bonus issue in the financial year 1980-81, only 2.8 per cent had seriously considered making a bonus issue that year but decided against it. One reason given was that "a decision was made instead to issue shares at par which bore a bonus component". Another company replied that "increased return (i.e. dividend on existing shares) was considered to be a better way of rewarding shareholders".

INVESTOR ATTITUDES

With regard to our survey of shareholders, questionnaires were sent to 160 non-corporate shareholders drawn randomly from eight companies which were also randomly selected from the 150 companies which had made at least one bonus issue in the year 1980-81. The 114 responses support the view that misconception about bonus issues is fairly common amongst private investors.

Shareholders were asked to rank the following types of 'return' they preferred to receive from their companies: bonus shares, dividends, and capital gain. Each form of 'return' was ranked first by approximately the same number of shareholders. More precisely, as many as 33.3 per cent of the 114 respondents ranked bonus shares as their most preferred form of 'return', another 32.5 per cent ranked dividends first and the remaining 34.2 per cent ranked capital gain first. Moreover, only 20.2 per cent ranked bonus shares as the least preferred form of 'return' as compared with 38.6 per cent for dividends and 42.1 per cent for capital gain.

If first and second preferences are taken together, 80 per cent of respondents ranked bonus shares as their first or second preference as compared with 61 per cent for dividends and 59 per cent for capital gain. Clearly, therefore, shareholders on average seem to have a high regard for bonus shares as a 'return' on their investment as compared with the more valid returns of dividends and capital gain.

If further evidence of misconception were needed, it is found in the response to the following question which was also put to these shareholders: "what do you believe the value of bonus shares to be: (i) valuable and therefore well worth receiving; (ii) of some value but not sure; or (iii) not of any value at all and not worth receiving?" Of the 114 respondents, 90 per cent supported (i), 9 per cent supported (ii), and only 0.9 per cent (i.e. one shareholder) supported (iii).

No significant relationship was found to exist between the level of personal income reported by respondent shareholders and the preference for a particular form of return. Although this might suggest that shareholders in all tax brackets attempt to reduce their tax liability to the same extent, it could also indicate a lack of concern about the tax implications of each form of return.

THE COST OF BONUS ISSUES

Bonus issues entail costs, a point which is often forgotten when analysing these issues. Strictly speaking, therefore, they are not free issues although they are sometimes described as such. The assets of the issuing company actually decline, if only very slightly, as a result of the costs of an issue. In order to get an approximate idea of the costs involved, our survey asked the 150 companies that had made one or more bonus issues in the year 1980-81 to indicate the approximate cash costs of making their most recent issue. These costs included items such as the cost of new share certificates, expenses in administering the issue, and mailing costs. 31.5 per cent of the respondents provided the approximate actual cost while 68.5 per cent provided a guesstimate.

Not surprisingly, the cost analysis revealed that the more shareholders a company had, the lower was the cost of a bonus issue per shareholder.[9] Costs ranged from a high of $69.92 per shareholder to a low of $0.13. For 95 per cent of the respondents, the cost was less than $5.00 per shareholder. The distribution was skewed with more companies showing a cost below $2.50 per shareholder than above $2.50. The unweighted average was $1.23 per shareholder for all respondents.

The average number of shareholders per respondent company was 4,898 (standard deviation 10,053), and the average issue costs per company were $6,009 (standard deviation $9,369).

ADDITIONAL FINDINGS

Those companies which made at least one bonus issue during the year 1980-81 were also asked for information about the reserves used for bonus issues, and profitability trends. The outcome for the 111 respondent companies was, briefly, as follows.

For all 221 bonus issues made by the 111 respondent companies during the four calendar years 1978-81, it was discovered that in about two-thirds of the cases an asset revaluation (or similar) reserve was debited for the purpose of making the issue. Share premium account was next and no issue was made out of past or current trading profits, presumably because of the tax implications.[10] The results are summarised in Table 2.

Thus the 'information package' role of bonus issues relates in many cases to asset revaluation and not only to profit and dividend prospects.

TABLE 2

	Reserves Debited	No. of Issues
1.	Share Premium	57 (25.8 per cent)
2.	Asset Revaluation (or similar)	150 (67.9 per cent)
3.	Combination of 1 and 2	14 (6.3 per cent)
		221 (100.0 per cent)

As regards profit trends, the 111 respondent companies indicated, on the whole, a more favourable picture than those companies which had not made a bonus issue during the year 1980-81. 68 per cent of the former reported a rising trend in profits for each of the three years 1978-80, as compared with only 49 per cent for the latter. This is consistent with the view that bonus issues have favourable informational content with regard to profit and dividend prospects.

A final point of interest concerning all bonus issues made during the year 1980-81 was that many of the issue ratios chosen were such that holdings of 100 old shares would have resulted in fractional bonus shares. If we exclude issues of one or more new shares for every old share, 86.5 per cent of all issues involved ratios that did not give a whole number of new shares per 100 old shares. Since such awkward ratios can easily be avoided in most cases, it would probably be a good move if the stock exchanges were to disallow them as is the case in some countries.[11] In this way the number of fractional bonus shares and the problems associated therewith could be substantially reduced.

CONCLUSIONS

At least three different views can be distinguished with regard to bonus issues:

(a) They are a useful capital restructuring procedure which can be justified on various grounds, particularly the benefit(s) which they confer on shareholders.

(b) They are a futile paper-shuffling exercise which, in view of their cost, actually reduces shareholder wealth. They therefore ought to be scrapped entirely.

(c) They normally do not increase shareholder wealth but they can be useful in an informational role — e.g. in conveying a favourable picture of the company's prospects, or in indicating to investors that the reserves which are capitalised by the issue are not distributable.

Clearly (a) and (b) are extreme views while (c) is somewhere in between. Our survey showed that some managers as well as many non-corporate investors appear to support (a), a view which is not consistent with the findings of various empirical studies in this and other countries concerning the value of bonus issues. These findings are more consistent with (b) and (c).

Too many financial journalists describe bonus shares as 'rewards' to shareholders without appearing to realise that these issues constitute, in essence, merely a book transfer from reserves to share capital account. Thus, in Australia at least, misconceptions with regard to bonus issues are perpetuated through the press. Education must sooner or later reduce the misunderstanding to a level where it is negligible or non-existent, but the process will probably be speeded up if the term 'bonus issue' (and its counterpart 'bonus shares') is scrapped by our legislators, the press, the stock exchanges and the investment community as a whole. A more accurate term would be 'free scrip issue' (although even this is not completely accurate because the issue is not costless)[12] or, preferably, 'capitalization issue'.

FOOTNOTES

1. This term alludes to the fact that a bonus issue entails a book transfer of funds from a company's reserves to its share capital account, i.e. reserves are 'capitalized' in a bookkeeping sense.
2. For further consideration of this statement, see Woods, I.R. "Are Bonus Issues Worthwhile?", *Professional Administrator*, vol. 33 no. 4 (October-November 1981).
3. The complete findings are in Pilioussis, T.A. "Bonus Share Issues in Australia", unpublished MBA Research Report, University of Melbourne, 1982. The research was supervised by Dr. I.R. Woods.
4. Reserve Bank of Australia, Bulletin Supplement, January 1982, p. 30.
5. See Ball, R., Brown, P. and Finn, F.J. "Share Capitalization Changes, Information, and the Australian Equity Market", *Australian Journal of Management, vol. 2 no. 2 (October 1977); Firth, M.A. The Incidence and Impact of Capitalization Issues (Institute of Chartered Accounts in England and Wales), Occasional paper no. 3, 1974, p. 96; Emanuel, D.M. "Capitalization Changes and Share Price Movements: New Zealand Evidence", Australian Journal of Management*, vol. 4 no. 2 (October 1979); and Sussman, M.R. The Stock Dividend (University of Michigan, 1962), p. 69.

6. This should not be taken to mean that the increase in the value of the firm is necessarily due to the increase in dividends. The latter, if unexpected by the market, signals an unexpected increase in earnings and some would argue that it is this which explains the increase in the value of the firm. See Miller, M.H. "Can Management Use Dividends to Influence the Value of the Firm?", *Chase Financial Quarterly,* vol. 1 no. 2 (Winter 1982).
7. The term 'dividend rate' normally refers to the dividend per share either as an absolute amount or as a percentage of the share's par value. It is used here in the latter sense.
8. On Australian stock exchanges the size of a marketable parcel depends on the price of the share. For the price range $1.01 — $10.00 a marketable parcel is 100 shares. Thus a parcel of $10.00 shares will cost $1,000 (excluding transaction costs) while a parcel of $1.10 shares will cost only $110.
9. In an attempt to derive a model for reflecting the total cost of a bonus issue for a particular company a regression analysis was performed. The regression equation $Y = a(X^b)$ had a correlation coefficient of 81 per cent.

   Hence: $a + 12.6239$ X = Number of Shareholders
   $b = 0.7239$ Y = Total Cost
   $r = 0.81$
10. Bonus shares issued out of share premium account, asset revaluation reserve or other capital profit reserves are not taxable in the hands of shareholders whereas issues made out of past or current trading profits are taxable.
11. E.g. The Johannesburg Stock Exchange (the only stock exchange in South Africa).
12. The term 'scrip issue', commonly used in London to describe bonus issues, can also be misleading because *any* issue of new shares, whether or not it is made at an issue price above zero, is in fact a scrip issue in the broad sense.