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Bonus issue of shares: A conceptual framework

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Abstract
The word "financial investment" describes an investment in financial assets, such as stocks, bonds, debentures, warrants, etc., with the goal of making money via dividends, interest, or capital gains on the value of the underlying instrument. These kinds of investments are associated with the dangers of capital blockage and capital loss. Bonus shares, which are a portion of the company's profits, are given to existing shareholders free of charge in proportion to their current stake in the business. Bonuses given to existing shareholders raise the total number of shares on the market, which has no effect on the company's current market value. Bonuses are seen as a mark of appreciation and a gift from the "Board" to shareholders. After obtaining the bonus shares, the investor is exempt from paying taxes. It is especially advantageous for investors who want to raise funds to invest in the firm because they trust in its long-term prospects. The bonus issue enables the corporation to save money for future business investments. It serves as a signal to the market, letting them know that the firm has faith in its future expansion prospects. This study examines the potential of bonus shares in India, as well as the benefits and drawbacks from the perspectives of shareholders and corporations. Overall, this study offers a thorough grasp of bonus issues for shares in the Indian context.

Keywords: Financial investment, bonus issue, capital blockage, dividend, capital gain

Introduction

Bonus issues are a way for corporations to turn cash reserves into stock. Since the money that was turned into share capital generally belongs to shareholders, they are not required to pay for these shares. A corporation accumulates a reserve by keeping a portion of its profits over time (the portion not paid as dividends) in order to offer bonus shares to investors. The corporation issues bonus shares from the capital account after transferring a portion of the money into it as these free reserves rise.

In order to show the company's more realistic earning potential and to reduce the unusually high dividend rate on its capital, bonus shares are being issued with the goal of bringing the amount of issued and paid-up capital into line with the capital utilized. When the corporation does not have enough cash on hand to pay dividends, it may also resort to bonus issues. That will ultimately result in more shares, which may be reflected in a lower share price. For the past few years, scholars have been debating the connection between bonus concerns and their effect on share prices. The distribution of freely additional shares to present owners in proportion to their existing shareholdings is known as a bonus issue. Although bonus issues raise the total number of equity securities in circulation, they have no bearing on the proportionate ownership of shares by shareholders. This is due to the fact that distributing a company's accumulated reserves through a bonus issue is essentially an exchange of retained earnings for the company's paid-up share capital. Therefore, even if current owners now own a greater number of equity shares, their relative claim on a company's assets remains unchanged.

The word "financial investment" describes an investment in financial assets, such as stocks, bonds, debentures, warrants, etc., with the goal of making money via dividends, interest, or capital gains on the value of the underlying instrument. These kinds of investments are associated with the dangers of capital blockage and capital loss. The most often issued instrument is common stock, owner's capital, or equity shares, which typically provide the possessor the ability to vote. Businesses essentially use dividends and capital appreciation to express gratitude to existing shareholders for their contributions. A dividend is a percentage of a company's profits that are given to shareholders at the discretion of the board of directors.

Dividend distribution may take many different forms. A) Dividend in Cash B) Splitting and Stock Dividends D) Special Dividend (additional dividend, spin-off, split-ups); C) Property Dividend. Among them, businesses that have significant prospects for future investments or that lack sufficient funds often capitalize their previous gains to pay dividends in a form of shares. These shares, known as "bonus shares," are awarded in lieu of cash dividend payments. Even if the legal description does not include the gift notion, the majority of investors see bonus shares as a "gift" from the company.

Bonuses are seen as a mark of appreciation and a gift from the "Board" to shareholders. Gifts, however, have corporate connotations. Numerous research studies examining the connection between stock dividends and share prices have been carried out in a variety of financial publications from different nations and organizations (such as bonus problems in Australia and script issues in the United Kingdom). According to empirical research conducted in the United States, the market typically responds favorably to announcements of stock dividends or bonus issues (US: Foster & Vickrey, 1978; Woolridge, 1983; Grinblatt *et al*., 1984; Mcnicholas & Dravid, 1990); Canada: Masse *et al*., 1987; New Zealand: Anderson *et al*., 2001; Sweden: Lijleblom, 1989). Bonus issues are when reserve gains are distributed to present shareholders as extra stocks based on their current investment holdings in the corporations.

A corporation typically pays out bonuses using its accumulated capital reserves or retained earnings. It has two effects: A company's distributed retained earnings will become paid-up capital in the stockholders' equity column of the balance sheet if it uses them for bonus issues. Conversely, a corporation converts its accumulated capital reserves into paid-up capital if it chooses to issue a bonus issue from those reserves. In both cases, the corporation does not get any money, but it does make a book entry and add stocks to each shareholder's holdings.

Although it leads the number of shares held by shareholders to increase relative to their prior holdings, it has no effect on the capital structure, financial position, or total proportion of the company to the shareholders. In their research, found that incentive payments and other dividends have no effect on shareholder value. The alteration brought about by the bonus issue is that the bonus issue ratio is used to alter the number of outstanding shares; hence, as the number of outstanding shares rises, the price of the securities falls. The market value of the shares as a whole or the investor's holdings stays the same.

SEBI Guidelines

To issue bonus shares in India, corporations must adhere to the rules listed below, which are established by the Security Exchange Board of India (SEBI), which oversees and regulates the Indian capital market.

a) Only free reserves generated from actual profits or share premiums received in cash may be used to issue bonus shares. Bonus shares cannot be issued by companies in place of dividends or in the event that they have released any rights or public offerings within the last 12 months.
b) Bonuses cannot be given on shares that have already been partially paid up.
c) The corporation should make sure it hasn't fallen behind on paying employees' statutory obligations or interest or principal on fixed deposits and debentures.
d) If the articles of association and memorandum do not include a clause allowing for bonus issuance with regard to authorized share capital or capitalization of reserves, they must be changed.

Advantages and disadvantages of Bonus Shares

Companies offer bonus shares in lieu of cash dividends. These have pros and cons like any wealth transfer. Both the issuing firm and the stockholder or investor are engaged, and we will go over the benefits and drawbacks of bonus shares through their perspectives.

What motivates an investor to purchase stock in a company? There are two possible explanations for this: long-term investment and dividend income generation. When an organization is run effectively and generates economic value, the first objective is achieved. The second objective is contingent upon the company's payment guidelines. A firm in its growth stage could choose to reinvest all profits back into the company rather than offering cash dividends. A well-established business could also be required to pay a consistent yearly cash dividend. However, both kinds of organizations may use a bonus issue to pay a stock dividend.

Benefits of Bonus Shares from the Perspective of Investors

After obtaining the bonus shares, the investor is exempt from paying taxes. It is especially advantageous for investors who want to raise funds to invest in the firm because they trust in its long-term prospects.

The belief of shareholders in the company's activities is bolstered by issuing more shares and allocating funds for the expansion of the firm. Due to the firm's previous policy of paying stock dividends, the investor has a lot of shares, so he will get a larger payout if the company decides to resume paying cash dividends in the future.

Bonus Shares' Drawbacks from an Investor's Perspective

Some investors could want money to achieve other goals, while others might not be interested in receiving the shares as a dividend. Such investors' stake in the organization decreases when they exchange their bonus shares to get cash. In order to maintain the company's market capital, the share price falls proportionately; therefore, the stock dividend fails to boost the wealth of the owners.

The perspective of the company

The capital requirements of an organization keep changing throughout the course of its existence. During the early stages of expansion, capital preservation is crucial, but as the organization matures, meeting the return needs of its stockholders takes priority. An organization may use a variety of methods to achieve its goals. Among them is the dividend payout method. An organization may decide to pay a cash dividend or a stock-based dividend, or it may be compelled to do so due to financial restrictions. Each has unique benefits and drawbacks, which are covered here.

Bonus Share’s Benefits from the Company's Perspective

The bonus issue enables the corporation to save money for

future business investments. It serves as a signal to the market, letting them know that the firm has faith in its future expansion prospects. When the business is unable to pay out cash, the only way to meet the shareholders' demand for a dividend is to provide bonuses.
Smaller investors participate in the company's shares more when the total quantity of outstanding shares is increased via a bonus issue, which improves the stock's liquidity.
The company's size is seen as having increased due to the growth in issued share capital.

Bonus Share's Drawbacks from the Company's Perspective

Bonus issues result in more shares of the corporation being issued, which lowers the cash dividend yield and future EPS. The market's perception of the company's worth may suffer as a result. Bonus shares are issued without any financial payment to the corporation. Consequently, the company's capacity to generate capital via subsequent offers declines. Paying a cash dividend is less expensive than managing a bonus share plan. If the organization continues to issue bonus shares, this expense may mount up over time.

Conclusion

Although bonus issues raise the total number of equity securities in circulation, they have no bearing on the proportionate ownership of shares by shareholders. The bonus issue enables the corporation to save money for future business investments. It serves as a signal to the market, letting them know that the firm has faith in its future expansion prospects. After obtaining the bonus shares, the investor is exempt from paying taxes. It is especially advantageous for investors who want to raise funds to invest in the firm because they trust in its long-term prospects.

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