INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, IT & MANAGEMENT

IJRCM

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SHARE SPLIT ANNOUNCEMENT AND MARKET REACTION: EVIDENCE FROM PUBLIC COMPANY IN INDONESIA STOCK EXCHANGE

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ABSTRACT

Share split is one of corporate activities done by the management to signal company's prospect. Share split phenomenon could be explained theoretically by signaling theory and trading range theory. The market reaction in this research is divided into two proxies, abnormal return and trading volume activities. The model used in this research is multiple regressions with the objective of testing the effect of abnormal return and trading volume activity to share split. The samples used during this research are 60 within 2008-2014. This research used 11 day event study to observe the market reaction on the announcement of share split. The result shows that higher split causes higher level of abnormal return and trading volume activity. It also shows market reaction on the announcement of share split. The reaction on the announcement of share split in two models indicates that the company succeeds to signal their good news of share split to the market. Moreover, the result also shows that split factor may give positive signal to the capital market that is in line with signaling theory.

KEYWORDS
share split, abnormal return, trading volume activity.

INTRODUCTION

Capital market is a place for those who have funds excess to channel it those who need the funds by trading the securities (Tandelilin, 2010:26). Security trading happens when the information coming into the market is responded by the investors. Capital market is an efficient market if the price of all traded securities reflects all the information (Fama, 1970). The concept of efficient markets explains an adjustment of securities price into the new price in response to the information coming into the market.

One of the issuer activities that potentially generate efficient information is corporate action. Corporate action is company policy taken by the managements to improve company's performance for short or long term. Share split is an example of corporate actions that has the potential of generating market reaction. The purpose of share split is to split the shares into multiple shares. In addition to the number of shares, par value per share will also change. Although the number of shares increases by a specific multiple, the most common example of split ratios are 2-for-1 or 4-for-1, the total price value of the shares remains the same compared to the pre-split amounts because the split does not add any real value.

Trading range theory reveals that the purpose of share split is to restore the share price into the price range desired by the company, so it can reach the market. An affordable price of the market will attract potential investors' interest and eventually improve the trading liquidity of the shares (Wulff, 2002). Abnormal increase of trading around the period of share split announcement will cause market reaction. The companies outlined two reasons of share split. First, share prices are not too expensive, so it could increase the number of shareholders and increase the liquidity of share trading. Second, share split is done to restore price and size of the average trading share to a desired range.

Management tries to send a positive signal to the market through the activities of share split. This is in line with signaling theory, where managers are trying to send information to shareholders and potential investors (Louis and Robinson, 2005). Share split is a common phenomenon Indonesia. Public companies such as PT Telkom Indonesia (Persero) Tbk. (TLKM) in 2013, PT Astra International Tbk. (ASII) in 2013, and PT JAPFA Tbk. (JPFA) in 2013 did share split with the factors of 1:5, 1:10, and 1:5. The board of directors of each company disclosed various objectives of the share split, including to make the market more animated, to reach retail investors, and also to make lower the price of outstanding shares (Latif and Sukirno, 2012). Those reasons can be explained theoretically by trading range theory and signaling theory.

Brigham and Daves (2010:605) revealed that share split is still a puzzling phenomenon in economics. This happens because the company does not receive a direct impact on cash flow from the action. Ewijaya and Indriantoro (1999) argued that, in line with the assumption of efficient market, share split from the perspective of accounting does not affect cash flow. Even though it does not directly influence company's performance, many companies still do this action. Setyawan and Hartono (2001) argued that share split contains other information that is not easily predicted by investors because each manager has a different motivation in doing share split.

Researches linking share split and market reaction have found different results. Chou, Lee, and Chen (2005), Dhar and Chhaochharia (2008), and Wulff (2002) found that market had a positive reaction to share split. However, other researches found that market did not react on share splits significantly (Brennan and Hughes, 1991; Gupta and Gupta, 2007; and Sutrisno, Yuniartha, and Susilowati, 2000). Gupta and Gupta (2007) found that there was no reaction from the market brought by the announcement of share splits in India. This is because most shares announced to be split are traded at a low price. In other words, market does not always react positively to the share splits.

Researches showing the existence of share split effect on market due to the content of information support signaling theory and trading range theory. On the contrary, the contradictive result, which found that share split have no effect on the market reaction (no information content), support efficient market hypothesis (Suntoro and Subekti, 2003). According to efficient market hypothesis, corporate action such as share split does not give any signal to the shareholders in the capital market (Setyawan and Hartono, 2001).

This research is conducted to strengthen the researches that have been done before. This research examines split factor as the determinants of market reaction. Split factor is information awaited by the market, which is the main characteristic of the share split, and it becomes the basis for the investors to react in the market. Split factor determine how much the price of the new shares are traded on the market. Higher number of split factor means lower price of shares. Lower price of shares will attract investors to invest. This research also tests market reaction in daily basis to determine when the market reaction occurs.

REVIEW OF LITERATURE

SIGNALING THEORY AND TRADING RANGE THEORY

According to Mason and Shelor (1998), the theoretical reasons of companies doing share split can be explained by two theories; trading range theory and signaling theory. Both theories explain the motivations and objectives of the company in doing share split. Signaling theory explains that any corporate action associated with a company has potential information content as a signal. When information is published as announcement to the market and accepted, market traders will analyze and sort it first into good news and bad news. If the announcement is a good signal for investors, there will be a change in the trading volume. The incoming information can be categorized into efficient information and efficient decision.

One example of corporate actions that contains information is share splits. The announcement of share split gives a signal to the public that the company has a promising prospect in the future. This statement is in line with Brennan and Hughes (1991), which states that share split conducted by issuers contains a huge cost that will be borne. Then, only well performing companies are able to bear the costs. The high cost of share split requires adequate cash inventory. If a company make a wrong decision in analyzing the situation, the company will be caught up in share prices that are too low (Grinblatt, Masulis and Titman, 1984). In general, good financial performance will provide a good signal to the market, so investors' perception of the company increases (Savitri and Martani, 2006).

Trading range theory explains that the purpose of share split is to keep the share price range not too high, and to increase the liquidity of the share trade. The shares are not liquid due to two reasons: the share price is too high and the amount of outstanding shares is too low. Investors are less interested to buy shares with high price, so the managements took initiative to reorganize the share prices in lower price range (Irvine, Lipson and Puckett, 2007). Share split makes the share price lower than before, so investors feel safe in trading shares at affordable prices (Kalay and Kronlund, 2009).

HYPOTHESES

Issuers split their shares when the price on market is too high. According to Griffin (2010), the high price of share is a signal that the company has a good prospect in the future. The high price of share will also lead to less stimulation of trade on the market. Trading range theory explained that the high price of share is the motivation for the company to do share split. The purpose of share split is to maintain the market price from being too high, so retail investors can afford it, and the shares on the market will be more stimulated with higher trading volume activity.

Louis and Robinson (2005), in his research, found that the decision to do share split is in line with signaling theory, as the CFO of the company expressed optimism that the company has good prospects in the future. The managements are trying to send a positive signal to the market through the activity of the share split. Market reaction can be measured through abnormal return and trading volume around the announcement date of the share split. Suntoro and Subekti (2003) found that share split announcement significantly influenced the abnormal return. There is a significant relationship of market reaction which is proxied by abnormal return around the announcement period of share split. Trading volume could be proxied by trading volume activity. Savitri and Martani (2006) found significant differences of share trading volume on the day prior to and after the share split.

Based on the description of the background research and the exposure of the theory that underlies share split, the hypothesis could be formulated as follows:

H_1 : There is a market reaction around the announcement period of share split.

H_2 : Split factor has positive influence on abnormal returns and trading volume.

RESEARCH METHODOLOGY

POPULATION AND SAMPLE

The populations in this research are the companies that performed share split and were listed on the Indonesia Stock Exchange (BEI) from 2008-2014. The purposive sampling in this research uses the following criteria:

1. The issuers do not conduct other corporate actions such as rights issue, dividend share, bonus issue, and other policies that could affect the abnormal return during the period of event window.
2. Shares owned by the issuers are traded actively for a minimum of 11 days around the announcement of a share split.
3. Data related to the share split information is available.

The sample selection based on the criteria above leaves 60 companies. The table below summarizes the calculation on the numbers of samples explained above.

TABLE 1: NUMBERS OF SAMPLES

No.	Descriptions	Amount
1	Population of companies doing share split during 2008-2014	62
2	Companies conducting other corporate actions	(2)
3	Shares owned by issuers are traded less than 11 days around the announcement of a share split	0
4	Issuers have an incomplete data	0
Number of samples used for the research		60

ABNORMAL RETURN

Abnormal return is the difference between the actual return and expected return. The amount of expected share returns can be measured by various methods. This research uses market model because it provides convenience in detecting abnormal return than other models. Market model has the potential to generate an intense statistical test compared to other statistical models such as mean adjusted model and market adjusted model (Hartono, 2013: 600). Investor reaction is measured using abnormal return by calculating Average Abnormal Return (AAR). The phases of calculation are as follows.

a. Calculating the actual return (Hartono, 2013: 207):

$$R_{it} = \frac{P_{it} - P_{it-1}}{P_{it-1}}$$

Note:

R_{it} : Actual return happens on *i* share during *t* period

P_{it} : Current share price

P_{it-1} : Previous share price

b. Calculating expected return using market model is done in two phases (Tandelilin, 2010: 574), first, formed the expectation model with the realization data during the estimation period and second, use this expectation model for estimate the expected return on the window period. Expectation model using OLS (Ordinary Least Square) regression techniques is as follows.

$R_{it} = \alpha_i + \beta_i \cdot RM_t + E_{it}$

Note:

R_{it} : Actual return on *i* securities during *t* estimation period

α_i : Intercept on securities *i*

β_i : Slope coefficient on beta securities *i*

RM_t : Return on market index during t estimation period

E_{it} : Residual error on *i* securities during *t* estimation period

c. Calculating the abnormal return for each issuer (Hartono, 2013: 580):

$AR_{it} = R_{it} - E_{Rit}$

Note:

AR_{it} : Abnormal return on *i* share during *t* period

R_{it} : Actual return on *i* share during *t* period

ER_{it} : Expected return on *i* share during *t* period

d. Calculating the average abnormal return (Hartono, 2013: 592):

$$AAR_{it} = \frac{\Sigma_{i=1}^{n} AR_{it}}{n}$$

Note:

AAR_{it} : Average abnormal return on *i* share during *t* period

n : Sample

AR_{it} : Abnormal Return on i share during *t* period

TRADING VOLUME

Trading volume is the number of shares traded during certain period, which, in this case, is the period when the company split its share. Trading volume is measured by Trading Volume Activity (TVA) by comparing the number of outstanding shares during a certain period and the number of outstanding shares at any given time. Then, the average on each trading volume of before and after the share split is calculated to determine the magnitude of the difference, the Average Trading Volume Activity.

SPLIT FACTOR

This research uses event study to observe the movement of abnormal return from day to day. The estimation period is 100 days, i.e. from t-6 to t-105, refer to research conducted by Savitri and Martani (2006). The estimation period used in the previous research quite varied. The longer the day use to estimate, more accurate the result in calculate expected return (Hartono, 2013:583). Events period in this research is 11 days, which is divided by t-5 (5 days before the announcement of share split) and t+5 (5 days after the announcement of share split). The observation on market reaction was documented and tested. The observation period of 5 days—before and after the announcement—is based on the working days of capital market in Indonesia, which is 5 days in a week.

Share split is an activity undertaken by a public company to increase the number of outstanding shares and to lower the share price. Share split with split-up solution is the reduction of the nominal value per share resulting increase in the number of outstanding shares. The characteristic of share split is having split factors. In this case, split factor is defined as the ratio between the number of outstanding shares before and after share split (Szewczyk and Tsetsekos, 1993). Split factors of 1:2, 1:3, and 1:4 are converted into value ratio; consecutively as 0,5; 0,33; and 0,25, and so on.

HYPOTHESES TESTING

Hypothesis 1 (H1) is tested with one sample t-test on the variable of abnormal return and trading volume for each day during the event period. This test reinforces the results of the previous testing by regression analysis. The significance of abnormal return and trading volume in the event period is statistically calculated by dividing the average of abnormal return and trading volume with standard error of estimated abnormal return and trading volume. Hypothesis will be supported if the t-count value is greater than t-table. T-table to be used is at the level of 5%.

Hypothesis 2 (H2) is tested using multiple regression models. The regression model used in this study determines the relation of split factor and average abnormal return and trading volume activity. The research model in this research is as follows.

$AARt = \alpha + \beta 1\ SFi + €i$

$TVAt = \alpha + \beta 1\ SFi + €i$

RESULTS & DISCUSSION

FIRST HYPOTHESIS TESTING

TABLE 2: RESULTS OF FIRST HYPOTHESIS TESTING

Variable	Model 1			Model 2		
	Hypothesis	**t-count**	**Sig.**	**Hypothesis**	**t-count**	**Sig.**
Constants		-3,024	0,004		12,305	0,000
Split Factor	+	4,469**	0,000	+	2,263**	0,010

Note:
*** = Significant on level 1%
** = Significant on level 5%
* = Significant on level 10%

Based on the statistical test table above, it is known that the split factor has a positive or unidirectional relation to the average abnormal return and trading volume activity. It indicates that any increase of the split factor will cause an increase on the average abnormal return. This result is consistent with the researches that found high ratio of split factor on the share split events leading to market reaction, which is the average abnormal return (Wulff, 2002; and Louis and Robinson, 2005). The positive mark shown by the split factor's coefficient is in line with the purpose of share split according to trading range theory, which is to return the share price in a range affordable for investors. Price affordability will increase purchasing power of investors and improve trading liquidity (Wulff, 2002). Transaction activity occurring after the announcement indicates that the market reacts to the announcement.

The positive reactions encourages investors to trade, so the share price of the companies conducting share split will increase. The reaction happens due to investor's confidence on the prospects of the company. These events can be explained theoretically by signaling theory. Share split requires high outlays. If a company signals information that is not credible to the market, the company will stuck in too low share prices. Then the share split is more directed to a mere press release than the provision of information to the market (Fama, 1970).

SECOND HYPOTHESIS TESTING

TABLE 3: RESULTS OF SECOND HYPOTHESIS TESTING

Variable	t-count AAR	t-count TVA	Sig. AR	Sig. TVA
D_{-5}	-2,148**	0,848	0,036	0,400
D_{-4}	-1,684*	0,171	0,097	0,865
D_{-3}	-1,506	0,835	1,37	0,407
D_{-2}	-1,028	0,605	0,308	0,948
D_{-1}	0,610	0,015	0,544	0,988
D_0	0,037	-0,343	0,970	0,733
D_{+1}	-1,282	-1,575	0,205	0,121
D_{+2}	-1,606	-0,921	0,114	0,361
D_{+3}	-2,507**	-1,500	0,015	0,139
D_{+4}	-2,178**	0,072	0,033	0,943
D_{+5}	-3,349**	-0,119	0,001	0,906

Note:
*** = Significant on level 1%
** = Significant on level 5%
* = Significant on level 10%
D_{-5} = 5 days before the announcement of share split
D_{+5} = 5 days after the announcement of share split
D_0 = The announcement day of share split
AAR = Average Abnormal Return
TVA = Trading Volume Activity

The market began to react on D-5, D-4, D+3, D+4, and D+5 indicating that abnormal return reacted significantly throughout the event of share splits. This condition is in line with trading range theory, which explains share split that results in declining share price has implications on optimal share price. Therefore, the market reacts around the announcement of a share split period. However, the market reaction shown by proxy of trading volume activity shows no reaction at all.

Significant reaction on the day before the announcement of share split indicates leakage of information used by investors to earn abnormal returns. Information leakage in the period of D-5 and D-4. These events represent the leakage of information. This may happen because market participants and investors know the company's activities in the future early, so they react early to gain a positive abnormal return. Significant market reaction also indicates that the market reacts to the announcement.

SIGNIFICANCE BASED ON SPLIT FACTOR RATIO

TABLE 4: SIGNIFICANCE BASED ON SPLIT FACTOR RATIO

Ratio	Sig. *Abnormal Return*	Sig. *Trading Volume Activity*
1:100	0,821	0,000**
1:20	0,203	0,010**
1:10	0,914	0,001**
1:5	0,000**	0,056
1:4	0,000**	0,982
1:3	0,149	0,817
1:2	0,490	0,985

Note:
*** = Significant on level 1%
** = Significant on level 5%
* = Significant on level 10%

This research is confirmed by testing the reaction of company has split factor ratio. The table above explains the significance of the split ratio factor based on the abnormal return and trading volume activity. The table of statistical test above explains the significance of the split factor ratio based on the abnormal return and trading volume activity. The market reacted in a ratio of 1:5 and 1:4 by proxy of abnormal return. This condition is explained by the number of companies conducting share split with the ratios. Twenty companies conducted share split at the ratio of 1:5, while 10 companies used the ratio of 1:4. Both ratios contribute 50% of research samples. Most investor chose to react to the company using the share split ratio leading to the market price that was neither too high nor too low.

The test results with proxy of trading volume activity indicate that the reaction occurs in the company with the split factor of 1:100, 1:20 and 1:10. Share split with higher ratios implies lower share price. Lower share price have the potential of attracting investors to include their holdings into the company. The price led to an increase on the volume of transactions in company with the aforementioned ratios. The number of companies in all three ratios is 13 companies.

FINDINGS AND CONCLUSIONS

Based on the test results, higher split factor causes the level of average abnormal return and trading volume activity gets higher. It shows that the market reacts to the announcement of share split. Reactions along the split factor announcement in two models show investor's reaction to the good news of the share split events throughout the observation period. This result also shows that split factor, which is a part of the share split, gives a positive signal to the capital markets, which is in line with the signaling theory.

Low share price has the potential of influencing investors who invest in odd lot to switch to round lot. The interest of investors to the low share price will increase the purchasing power, which in turn increases the company's liquidity. The Increasing liquidity of companies due to the low share price after the share split is in line with trading range theory.

LIMITATIONS AND SCOPE FOR FURTHER RESEARCH

One proxy to measure market reactions, which is the abnormal return, is market model approach. Market model approach uses market return with IHSG (Indonesia Composite Index) as the basis of calculation. IHSG is a macro market price in Indonesian Stock Exchange, so it tends to ignore the circumstances of each company's industry. Future researches may consider the use of specific industry market price to calculate the market return. In addition, it is recommended to use industrial market prices in the calculation of the market model approach, since it will give an abnormal return that reflects the circumstances of the companies in industry.

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