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# Bonus and Wealth - A Conceptual Review

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**Abstract:** ***Over the years, finance literature is enriched with numerous researches focusing on tools to be practiced for wealth creation. Shareholders' wealth maximisation has always made the researchers puzzled and inspired to solve it differently.The present study focus to investigate role of bonus announcements for capitalizing the wealth creation opportunities. The study contributes to the existing literature on shareholders' wealth creation through informational content impact of bonus issue announcements. The study provides a conceptual framework to understand bonus and wealth creation from a synthesis of literature on bonus. Prevailing literature puts forward mixed views on wealth creation through bonus issue announcements with a focus on the entire index. Sector specific findings with varied time horizon still remains an interesting avenue to be explored further.***

**Keywords:** Bonus Issue, Wealth Creation, Information Content Analysis

## 1. Introduction

*'Money is what money does'* is an important concept leading to a more direct rationale, 'Wealth is what one does with the money'. Whether one likes or not but money does play a critical role in life for satisfying the needs, though wants and desires might still be considered differently by every individual. Following the premise of time value of money, wealth creation is how effectively one can use money to generate more money from money itself. The best investment is the one which leads to money working to earn more money. The theory of wealth boils down to the fundamentals of economics and personal finance.

The fundamental economic equation of *Savings(S) = Income(Y) – Expense(E)*, needs to be altered as per the conventional understanding of personal finance for sound and long-term wealth creation. The equation one should follow is *Expense(E) = Income(Y) – Savings(S)* the mathematical result doesn't change with change in the placement of variables in an equation. However, the change in equation from S = Y – E to E = Y – S clearly reflects the change of priority from spending to saving. It is easy to define the amount of saving as per needs but not easy to practice every time in life, resulting into majority of the individuals ending up spending beyond limit that is more than income. A systematic planning and execution of the perspective of save first and then take balance as your income to spend as much as you can by default helps the saved money to work for oneself and generate wealth.

## 2. Wealth Creation – A background

Further, the ancient mercantile rudimentary theory dates back to Kautilya's documentation of continuous and active action as a route to wealth generation [1].This emphasizes on the importance of proactive and well assessed action to attain the financial goals. This theory has lead numerous researches evolving into tools of wealth creation. Varied mechanisms through news as well as strategic decisions' announcements have been widely used by corporates to communicate prospects of a firm. The prime motive is to have a favorable impact on market prices and building investors' inclination towards the firm leading to wealth creation. The varied forms of dividends have been extensively used by corporates and in turn studied by researchers in diverse contexts for postulating the prospects generating wealth.

Shareholders' wealth maximisation has always made the researchers puzzled and inspired to solve it contributing with a fresh aspect. The information asymmetry comes as an add-on constraint to the puzzle. The culmination of findings by Black in 1976 escalated the urge and dynamics of dividend puzzle [2]. The sharing of a corporate's earnings through dividend can be in form of cash or shares. With the advent of interpretation on IFRIC – 17 for distributing of non-cash assets to owners, by International Financial Reporting Interpretations Committee (IFRIC)[3], the term bonus is considered out of the purview of the definition of dividend. The present study therefore uses the terminology Bonus except for citing reviewed literature the term used in respective research is mentioned for bonus.

## 3. Bonus – A contextual variation

A contextual variation is evident from the literature for bonus across economies. The prima facie variation lies in the term with which a dividend announcement's forms have been referred among various developed and developing economies across the world. A portion of earnings shared in form of non-cash dividend is denoted diversely, starting from stock dividend to scrip dividend to scrip issue to non-cash dividend to bonus to bonus issues. Researchers have reported for distribution of a company's earnings in form of share as stock dividend from US evidences, as scrip issues through evidences from U.K. to bonus issue (commonly referred as bonus) through evidences from major emerging economies like India, China and so on[4]. Many studies have used the same terminology stock dividend for bonus as well as stock splits. The first step in the research calls for a well-defined term specifying its inclusions so as to make the findings effective.

The next step after defining the terminology is to understand that bonus is one form of dividend though not part of dividend. The bonus decision are not mandatory for a corporate except for few countywide settings like prevailing in Oman where it is mandatory for corporates to give bonus.Primarily, bonus issue is nothing but distribution of earnings past or present from a corporate, in form of equity shares, at no additional cost to its equity shareholders proportionately based on their current holdings of equity shares.

Past studies also reveal minor variation in the denomination defining the quantum of bonus that is bonus ratio (BR). In developed economies the quantum of bonus distribution referred as bonus ratio is denoted in percentage terms with number of new bonus shares in nominal value divided by the nominal value of issued capital before bonus. In India the BR is represented in form of a ratio. The proportion of BR is calculated dividing the bonus shares with the existing equity shares of a corporate. Also, variation in interpretation of the ratio is also evident in literature. Majorly a BR of 3:5 reveals issue of 3 bonus equity shares for every 5 equity shares held by a shareholder. The next step in review focus on the methodology adopted for assessing rationale and reparations of the bonus announcement.

### 3.1 Role of Event-study

Almost all the studies documenting drivers for and impact of bonus announcements are based on the fundamental concepts of the Event Study Methodology (ESM) first documented by Dolleyin 1933 and later developed through ground breaking work of many researchers in finance and economics[5]. Most of the studied have concluded for superiority of applying daily returns, consideration of risk in estimating excess returns and incorporating industrial effects.

The credit for the fundamental research in the bonus domain goes to the seminal work by Barker[6]. The domain kept on growing and becoming more refined with multidimensional research incorporated in analyzing impact of bonus considering country specificandcompany specific factors.

## 4. Bonus – A Conceptual Framework

Figure – 1 outlines the conceptual framework to be followed for indulging into bonus and wealth. The road map of bonus and wealth begins with theoretical understanding of drivers for bonus. The initial literature attempts to solve the question of why will a company distribute bonus share? The answers with identifying varied factors leading to a bonus decision concluded with development of six varied hypothesis testing the rationale for the decision. The evidences reveal trading hypothesis also known as liquidity hypothesis as unlike dividend, bonus doesn't entail any cash outflow. Few studies also referred to this rationale through cash-substitution hypothesis and signaling hypothesis. Majority of the studies have attempted to identify the role of bonus as a signal from managers using trading hypothesis and/or signaling hypothesis. The widely tested hypothesis of liquidity and signaling interestingly concludes with major studies favoring the hypothesis.

The second stage in the bonus and wealth framework is for testing the bonus informational content impact using ESM followed by stage three of impact evaluation on wealth due to bonus. The application of ESM will aid in assessing the incidences for wealth on the basis of information communicated to the market through announcement news and how the news are being perceived. The immediate step to continue the path of assessing wealth concentrates on measurement of impact. Studies have attempted to measure the impact mainly on the day announcement comes that is announcement day, on the ex-bonus day that is immediately following working day from which a shareholders isn't entitled to the benefit of receiving free shares in form of bonus. Literature over years still lacks conclusive evidences for both the step making new research avenues focused with consideration of country specific and company specific factors.

The conceptual framework ends with the last step of using the findings of all three stages to make well informed investing decisions for capturing the informational impact of bonus issue.

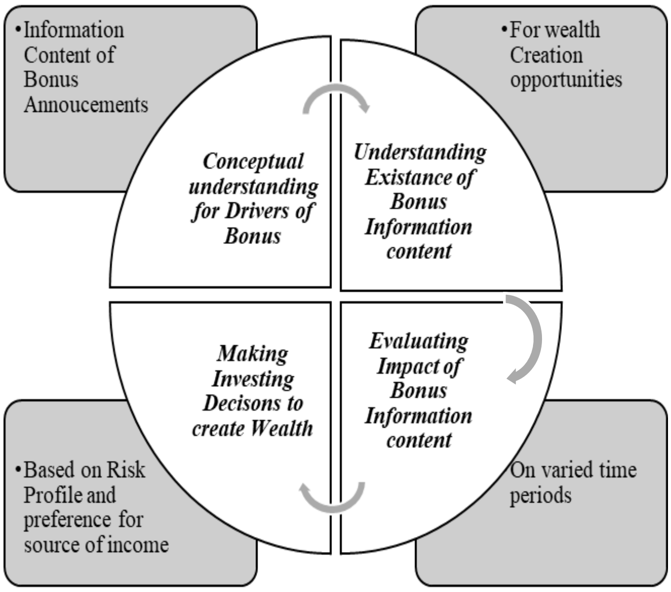


**Figure 1:** Conceptual Framework for Bonus and Wealth

The ultimate base of taking decisions leading to wealth boils down to assessment of two aspects, mainly risk profile of an investor and his or her preference for the source of income. Whether the aim is get liquidity or capital gain from market price appreciation. For getting liquidity it is preferable to hold shares of bonus giving company and receive free shares. While if the aim is to earn wealth than systematic planning and execution is needed so as to generate wealth from market price appreciation as literature postulates the phenomenon is momentary.

## 5. Findings and Implications

The study witnessed unique dimensions of bonus announcements studies starting from drivers to impact to ultimate decision. Majority of the literature hasconcentrated on the index of the respective country for analyzing the bonus. Significant negative wealth effects are observed on and around bonus as proposed by the information content hypothesis. All stakeholders are likely to find the information content of bonus announcements as a tool for shareholders' wealth management for varied time horizons. To attain maximum wealth creation for shareholders, focus should be on sector specific announcements' impact rather than only on announcement type as well as generalizing it to whole index. Also, a comparative analysis of bonus informational content for wealth creation can be done across developed and emerging economies to identify the distribution trend and impact.

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