

STOCK DIVIDEND

Stock Split

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Stock Dividend

In the present time, the stock dividend has become important concept. When dividend is given in form of stock, it is called stock dividend. In this form of dividend, the cash does not use. It is important, when the corporation declares stock dividend, the market value of the share decreases because the number of stock increases. The many companies prefer stock dividend due to the tax benefit. If the individual gets stock dividend, he does not pay any tax on stock dividend. Thus the stock dividend reduces tax burden. On the other hand, the ownership of investors also spurs up in the company because the number of holding share increases. There is also disadvantage of stock dividend. The market value of the share decreases, so the market value of holding also decreases (Kennon, 2009).

The ABC Company is leading company in its industry. The number of outstanding share of the company is one million. On the other hand, the number of investors is five millions. The value of market capitalization is \$100 million. The management declares 20% stock dividend. Thus the 200000 shares will be distributed as a stock dividend. The number of outstanding share will be increased by 200000 and the new total number of outstanding stock will be 1.2 million. On the other hand, the new value per share in the market will be \$83.33 (100 million/1.2 million). This example is taken from below mentioned link:

http://beginnersinvest.about.com/od/dividendsdrips1/a/aa040904_2.htm

Stock Split

The stock split is also an important concept. When the management wants to increase number of shares, the management follows this method. In this method, the face value of the share is split and number of share gets increased. Due to increment in number of outstanding share, the market value of per share also gets affected but the total market capitalization of the company does not affect. Both stock split and stock dividend increase number of outstanding

shares but both are different due to the accounting treatment. In the stock split, the investors do not get any real benefit. It is also known as non-cash distribution of dividend. The motto behind stock split is to increase trading of the shares in the market (Baker, 2009)

For example, the face value of per share is \$100 and the total outstanding shares are 100 million. If the management of the company announces stock split in ratio of 1:2, the total outstanding shares will be increased by 100 million, thus the new total number of the share will be 200 million. On the other hand, the face value of the share will reduce by 50%. So the new face value of the share will be \$50. Due to effect of stock split, the holding share of the investor will also increase in the prorated basis. If the investor has 10 shares, now he will have 20 shares. It is an important thing that the total issued capital will not be changed. The illustration of stock split has been got from following link:

<http://www.teenanalyst.com/stocks/splits.html>.

Reverse Stock Split

The reverse stock split is just opposite of stock split. In this process, the management reduces the number of outstanding shares. The company increases face value of the share. In this method, the corporation decides a ratio such as 2:1. Thus the company accumulates two shares in one share. In this method, the total market value of the company does not change. Due to reverse stock split, the earning per share and face value of per share rises. Thus the reverse stock split provides just opposite result from stock split. It is an important question, why a company selects this method. When the management seems that the face value of the share is less as compared to competitors then the company goes for this method to make its share value equal to competitor's share's face value. It is also a sound strategy to increase trading of shares. If the face value of share is