The 1st International Conference on Business and Engineering Management (IConBEM)
February 1st 2020, Institut Teknologi Sepuluh Nopember, Surabaya, Indonesia

Market Reaction of Stock Split Announcement on Listed Companies in Indonesia Stock Exchange

Adhe Erma Laurenchya
Department of Management, STIE Perbanas Surabaya, Surabaya
e-mail: renchya.laurenchya@gmail.com

Abstract—**The Issues of stock split is still debatable in the economic field. This is indicated by the mismatch between the theories referred to with practices in the capital market. The focus of the research is to investigate the determinant of the market reaction in the period before and after the announcement of a stock split. This study is designed by qualitative research by using theoretical review based and supporting by previously research. The basic concept underlyed the theoretical review are dimension of trading volume activity, abnormal return, and bid-ask spread. By critical review and classifying the result of previous research, the research found some propositions : (1) stock split have effect on trading volume activity (2) stock split have effect on abnormal return (3) stock split have effect on bid-ask spread.**

Keywords—**Stock Split, Trading Volume Activity, Abnormal Return, Bid-Ask Spread.**

I. INTRODUCTION

THE last few years the capital market in Indonesia is growing rapidly. This is indicated by the number of shares traded and the higher trading volume of shares in the capital market. The capital market is a market for various financial instruments that can be traded, both in the form of financials, shares, derivative instruments, and other instruments [1]. Of the several instruments in the capital market, shares become the main product offered and the main market goal in a country is to trade stocks. The development of activities in the capital market must be balanced with the correct quality of information.In the capital market a lot of information that can be obtained by investors both public information or personal information. Some of the public information presented includes Stock Split, trading volume, and stock prices. Stock Split (stock split) is the breakdown of the nominal value of shares into smaller fractions [1]. The purpose of this stock split is that trading of a stock becomes more liquid, because the number of shares outstanding becomes more and the price offered becomes cheaper so that it can involve more buyers than before. So the more transactions that occur, the company's stock liquidity will also increase in hopes of obtaining greater profits.

Announcement of Stock Split by the company in addition to changing stock prices is also a signal by the company to give an illustration that the company has a good development that is able to do a stock split [2]. The development of a good company can be seen from the good value of the company and also the increase in the company's stock price. This is related to the signaling theory. When the announcement reaches the public, the public will automatically receive and process the information. The spread of this information will certainly affect investor perceptions about the development of the company. Relevant information can help investors assess the performance prospects of the issuer, so that investors have a picture of the risks and expected returns on funds that will be or have been invested. The information used to assess an efficient market is information that is published as a study that studies the market's reaction to an event called an event study.

Ketut Utama Y., Gusti Ayu P., Made Arie W., (2017) conducted research on comparative analysis of trading volume activity and abnormal returns on companies that conduct stock split. The results obtained from this study there are differences in abnormal returns in the period before and after the stock split. Ketut Utama Y., et al's research is supported by research conducted by M. Taufiq Noor (2009) that discusses the analysis of abnormal returns, trading volume activities, and bid ask spreads around announcements of stock split. The result of this study there is a significant difference between abnormal returns in the period between now and after a stock split. Stock Split can cause stock prices to be cheaper than before, so that these shares can be reached by investors and can increase the liquidity of these shares. With an increase in stock trading activity, it will increase demand for these shares, which will make the stock price increase little by little from the price of new shares after the Stock Split. An increase in stock prices from day to day allows changes in stock returns which will ultimately result in changes in abnormal returns.

Ali Sadikin (2011) conducted research on the Analysis of abnormal returns and trading volume activity, before and after the stock Split Event. The result of this study there is a significant difference in stock trading volume activity between the period before and after the announcement of the stock split. Ali sadikin research is supported by research conducted by Dwi Rahayu and Wahyu Murti (2017) that discusses the stock split effects on stock returns, bid-ask spreads and trading volume activities. The result of this study there is a significant difference in trading volume activity in the period before and after the stock split.

Another indicator that can be used to see the market reaction to a stock split announcement is the Bid-ask spread. Bid-ask spread is the difference between the purchase price (bid price) and the selling price (ask price). The selling price or bid price is the highest price offered by market participants, while the selling price or ask price is the lowest price at which market participants are willing to sell their shares. A high bid-ask spread will result in a higher profit potential, but if the bid-ask spread is too high, the company's shares will become less actively traded. Conversely, a low bid-ask spread will result in lower profit potential, but if a low bid-ask spread causes the company's shares to become more actively traded.

II. THEORITICAL FRAMEWORK, LITERATURE REVIEW, DISCUSSION AND HIPOTHESIS

A. Stock Split

Stock split is the breakdown of the nominal value of shares into smaller fractions [1]. Stock split is an activity of increasing the number of outstanding shares by decreasing the nominal value of shares proportionally, while the capital balance and retained earnings remain. Stock split aims to make trading a stock more liquid, because the number of shares outstanding becomes more and the price becomes cheaper. With the stock split, the number of shares owned by shareholders has increased by a smaller nominal value per share, but at the same time the share price will theoretically decrease proportionally. The announcement of the stock split itself is considered a signal given by management to the public that the company has good prospects in the future [3]. This reason is also supported by the fact that the company that conducts stock splits is a company that has good performance. Only companies that truly have a signified condition will get a positive reaction.

B. Signaling Theory

Signaling Theory states that stock splits provide information to investors about the prospects of a substantial increase in future returns. The information provided to these investors is asymmetric information. Asymmetric information is private information that is only owned by investors where they only get some information. This will be seen if management does not fully convey all information obtained about all things that can affect the company to the market, then generally the market will respond to that information as a signal of certain events that can affect the value of the company reflected by changes in stock prices.

C. Trading Range Theory

Trading Range Theory states that stock splits can increase the liquidity of a company's stock trading. Companies do stock splits because prices are too high so potential investors are unable to reach them. According to this theory stock prices are too high causing illiquid shares, it relates to the ability of each different investor, therefore the company conducts stock split in an effort to direct the stock price at certain intervals that are not too expensive. Thus, according to Trading Range Theory, the company conducts prospective investors because it views its shares too high.

D. Trading Volume Activity

The volume of stock trading or Trading Volume Activity is the number of stock transactions traded at a certain time. Volume is needed to move a company's stock price. Stock trading volume is considered as a measure of market strength or weakness. When stock trading volume tends to increase when prices decline, the market is said to be bearish. When stock trading volume tends to increase as long as prices increase, the market is indicated in a bullish state. The increase in trading volume is an increase in buying and selling activities of investors on the stock exchange. Increasing the volume of supply and demand for a stock, the greater its influence on fluctuations in stock prices on the stock exchange, and the increasing volume of stock trading shows the more desirable of these shares by the public so that it will bring an effect on rising prices or stock returns. The volume of stock trading before the announcement of stock split (stock split) shows that companies that conduct stock splits experience lower stock trading liquidity than companies that do not do stock splits. Trading Volume Activity can be measured using the following equation [3]:

$$\text{TVA} = \frac{number\ of\ shares\ traded\ at\ a\ certain\ time}{number\ of\ shares\ outstanding\ at\ a\ certain\ period} \quad (1)$$

E. Abnormal Return

Market efficiency is tested by looking at abnormal returns that occur in the market [4]. The market is said to be inefficient if one or several market participants can enjoy abnormal profits for a long period of time. Abnormal Return is an excess of return or profit that actually occurs against normal returns. A positive abnormal return is obtained if the realized return is greater than the expected return. If the expected return is greater than the realized return, then a negative abnormal return occurs. A positive abnormal return indicates that market participants responded to the stock split announcement as good news.

Abnormal returns can be calculated using the following equation:

$$AR_{i,t} = R_{i,t} - E[R_{i,t}] \quad (2)$$

Information:
ARi, t : Abnormal Return stock i on day t
Ri, t : Actual Return of shares i on day t
E [Ri, t] : Expected Return of the stock i on day t

F. Bid – Ask Spread

Bid-ask spread is the difference between the purchase price (bid price) and the selling price (ask price). The selling price or bid price is the highest price offered by market participants, while the selling price or ask price is the lowest price at which market participants are willing to sell their shares. A high bid-ask spread will result in a higher profit potential, but if the bid-ask spread is too high, the company's shares will become less actively traded. Conversely, a low bid-ask spread will result in lower profit potential, but if a low bid-ask spread causes the company's shares to become more actively traded.

Bid-ask spread according to Fatmawati (1999) is a presentation of the difference between bid price and ask price. To determine the bid-ask spread, you can calculate the percentage spread by using the buy and sell prices during the window period. The spread percentage can be calculated using the formula:

$$\%\ Spread_{i,t} = \frac{\text{ASK t} - \text{BID t}}{(\text{ASK t} - \text{BID t})/2} \quad (3)$$

G. The Effect of Stock Split on Trading Volume Activity

When a company takes corporate action in the form of a stock split, it will have an impact on the trading volume of shares before and after the announcement of a stock split. Trading volume is the number of stock transactions traded at a certain time. Trading range theory states that a stock split can increase stock trading liquidity. With the Stock Split, it will encourage more and more investors to buy shares

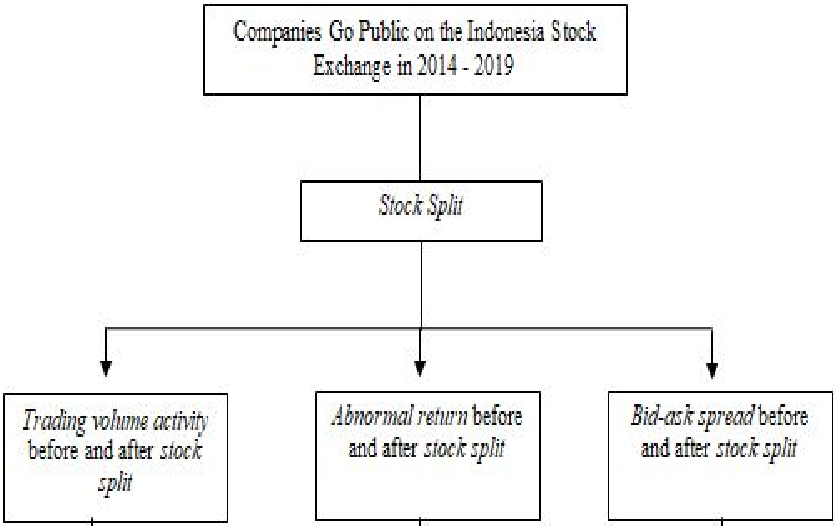

Figure 1. Research Framework

because the stock after the stock split is getting cheaper. Ali Sadikin (2011) conducted research on the Analysis of abnormal returns and trading volume activity, before and after the stock Split Event. The result of this study there is a significant difference in stock trading volume activity between the period before and after the announcement of the stock split. Ali sadikin research is supported by research conducted by Dwi Rahayu and Wahyu Murti (2017) that discusses the stock split effects on stock returns, bid-ask spreads and trading volume activities. The result of this study there is a significant difference in trading volume activity in the period before and after the stock split.

H. The Effect Stock Split On Abnormal Return

Stock Split can cause stock prices to be cheaper than before, so that these shares can be reached by investors and can increase the liquidity of these shares. With an increase in stock trading activity, it will increase demand for these shares, which will make the stock price increase little by little from the price of new shares after the stock split. An increase in stock prices from day to day allows changes in stock returns which will ultimately result in changes in abnormal returns. Signaling theory explains that stock splits provide information to investors about the prospects of a substantial increase in future returns.

Ketut Utama Y., Gusti Ayu P., Made Arie W., (2017) conducted research on comparative analysis of trading volume activity and abnormal returns on companies that conduct stock split. The results obtained from this study there are differences in abnormal returns in the period before and after the stock split. . Ketut Utama Y., et al's research is supported by research conducted by M. Taufiq Noor (2009) that discusses the analysis of abnormal returns, trading volume activities, and bid ask spreads around announcements of stock split. The result of this study there is a significant difference between abnormal returns in the period between now and after a stock split. Stock Split can cause stock prices to be cheaper than before, so that these shares can be reached by investors and can increase the liquidity of these shares. With an increase in stock trading activity, it will increase demand for these shares, which will make the stock price increase little by little from the price of new shares after the Stock Split. An increase in stock prices from day to day allows changes in stock returns which will ultimately result in changes in abnormal returns.

I. The Effect Stock Split On Bid-Ask Spread

Bid-ask spread is the difference between the purchase price (bid price) and the selling price (ask price). The selling price or bid price is the highest price offered by market participants, while the selling price or ask price is the lowest price at which market participants are willing to sell their shares. A high bid-ask spread will result in a higher profit potential, but if the bid-ask spread is too high, the company's shares will become less actively traded. Conversely, a low bid-ask spread will result in lower profit potential, but if a low bid-ask spread causes the company's shares to become more actively traded. With this stock split it is expected that the spread will not be too high because the price offered is also cheaper and the price is more affordable for investors.

J. Research Framework

Based on the theoretical basis and previous research that has been explained, encourage researchers to analyze the impact of stock split announcements made by companies listed on the Indonesia Stock Exchange on several indicators used to see market reaction and the hypotheses of this study are as follows:

H1 : There are significant differences between abnormal return before and after the stock split of companies listed on the Indonesia Stock Exchange in 2014 to 2019

H2 : There are significant difference between trading volume before and after the stock split of companies listed on the Indonesia Stock Exchange in 2014 to 2019

H3 : There are significant difference between the bid-ask spread before and after the stock split of companies listed on the Indonesia Stock Exchange in 2014 to 2019.

III. RESEARCH METHOD

The focus of the research is to investigate the determinant of the market reaction in the period before and after the announcement of a stock split. This study is designed by qualitative research by using theoretical review based and supporting by previously research. The basic concept underlyed the theoretical review are dimension of trading volume activity, abnormal return, and bid-ask spread.

IV. SUMMARY

In this study, it was explained that there was a market reaction due to a stock split announcement if the information received by the public was evenly distributed. If the market does not react, there are two possibilities: first the investor does not get more information about the announcement of a stock split, the second investor considers that the stock split announcement does not provide a positive signal (good news). With the unequal information about stock split, the dealers only deal with investors who have information. Because only investors who have information can carry out transactions, the trader will bear the cost of greater share ownership.

REFERENCES

[1] T. Darmadji and H. Fakhruddin, *Pasar Modal di Indonesia*. Jakarta: Salemba Empat, 2011.

[2] N. A'la, "Reaksi pasar terhadap pengumuman stock split tahun 2016," *J. Ilmu Manaj.*, vol. 5, no. 3, pp. 1–14, 2017.

[3] Z. A. Zein, N. Indrawati, and E. Hariyani, "Pengaruh stock split terhadap harga dan likuiditas saham," *J. Ekon.*, vol. 17, no. 2, pp. 9–20, 2009.

[4] J. Hartono, *Teori Portofolio dan Analisis Investasi*. Yogyakarta: BPFE, 2007.