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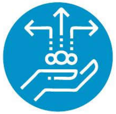
money basics

Understanding stock split

WHAT IS IT?

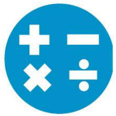


Stock split is a corporate action in which a company's shares increase but the market cap remains the same. "Stock split is splitting of shares by a certain denomination like two, three and four, which increases the total outstanding shares by two times, three times and so on. The share's value declines by the corresponding denominator, but the market capitalisation remains the same," said Navin Kulkarni, head of research at Reliance Securities. The existing shares of the company are split but the market value of each share falls, keeping the total value of equity capital the same, but changing the number of shares.

WHY IS IT DONE?

The number of shares you hold increases. "Shares held go up by the split number. So if one is holding 100 shares of a company and the company announces 1:10 split, the number of shares held goes up by 1,000 shares," said Kulkarni. Companies go for a stock split to improve the liquidity of shares and also to make it more accessible for retail investors. It expands the customer base for the company. "Investors tend to avoid high-market value stocks while institutional investors avoid low liquidity stocks. Thus, after stock split, firms see improvement in demand for stock," said Sanjeev Hota, head of research, Sharekhan.

THE MATH



Gujarat Gas had 14 crore shares and it announced a stock split into ₹2 per share from ₹10 per share. The number of shares with investors increased in 5:1 ratio (five shares for every share held) with outstanding shares at 69 crore, said Hota. But the portfolio value remained unchanged as price also reduced in the split ratio. "If you hold 100 shares in Gujarat Gas at ₹717 per share, the value of portfolio is at ₹71,700. After the split from face value of ₹10 to ₹2, you hold 500 shares of Gujarat Gas. Thus, the stock price also got adjusted and reduced to ₹143 per share in January from ₹717," Hota added.