Academic Research

Net share issues and the cross-section of equity returns under a dividend imputation tax system

There is strong empirical evidence that stocks that issue new shares experience negative abnormal returns following the issuance. In contrast, stocks experience positive abnormal returns following share repurchases. This behaviour of markets is called the Net Share Issuance anomaly. The explanation of this anomaly follow two schools of thought. The behavioural drives follow from the market timing of insiders. The risk drivers follow that stock repurchases reduce firm equity, increasing debt-to-equity ratios, which increase risk and expected returns.

This paper examines the Net Share Issuance anomaly in the Australian equity market over the period 1975-2010. This long sample period enables a unique opportunity to examine the drivers of the anomaly. The authors use the introduction of the imputation tax system in 1987 as a quasi-natural experiment. As the imputation system lowers the cost of equity, this provides an incentive for equity financing. Therefore, if market timing is a driver of the anomaly, then we should see a weakening of the size of the anomaly following dividend imputation given the additional noise to the financing decision. The authors show that in contrast to the market timing hypothesis, the Net Share Issuance anomaly has become stronger since the introduction of the imputation tax system, this is interpreted as providing support for the risk based explanation for the anomaly.

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Important information

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