

Impact of Dividend Announcement on Share Price: Evidence from Colombo Stock Exchange

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Abstract

This study investigates the Impact of Dividend Announcement on Share Prices of listed companies in Colombo Stock Exchange for the period of 2016 to 2017. The first and final Dividend Announcement data and Share Prices were extracted from 47 listed companies in CSE. This study's sample belongs to 60 Dividend Announcements in the period from 2016 to 2017. The Standard Event Study Methodology is used to examine the stock market response to Dividend Announcements and both Market Model, and Regression Analysis Methods were applied to analyse collected data in relation to computing the Abnormal Return, Excess Return, and Average Abnormal Return and T Values surrounding the Dividend Announcement date. The positive Abnormal Return indicates that there is an impact on Share Prices that means the Share Prices have been increased surrounding the event date. The corporate literature for Dividend Announcements on market response provide mix results as some of the prior literature suggests that there is a direct relationship between firm's Dividend Announcement and Share Price and some studies suggest that there is no relationship between Dividend Announcements and Share Prices. This study has studied those contradicting theories, and the finding shows that Dividend Announcements do not lead to positive or negative market reactions towards Market Prices in the Colombo Stock Exchange.

Keywords: Share Price, Colombo Stock Exchange, Impact of Dividend

Introduction

Every ultimate organisation objective is to maximize the shareholders' wealth Olowe, (1997), the objective can achieve according to the two approaches one is allocating profit among the shareholders or reinvesting profit as a retain earning. All commercial organizations distributed profit among shareholders as a dividend. The organizations are practiced a different kind of dividend payments the study going to identify the relationship between dividend announcements and the firm's share price. The relationship between dividend and the firm's share price has been investigated so many scholars. However, all empirical results have a different kind of contra dictionary. Therefore, still, this relationship is a puzzle as to whether or not dividends have an effect on the value of a firm or a firm's stock price.

The owners or shareholders of any business expect their investments to earn a return that rewards them for bearing risk. The level of reward is expected to commensurate with the perceived riskiness of the investment. There are many alternative vehicles for the investment of capital, so a particular investment can often be said to carry an 'opportunity cost.' This is the difference between the actual return achieved and the potential return forgone from the alternative investment.

Olowe, (1997) mentioned listed companies on the stock exchange, shareholders who are not satisfied with the performance of their investment are able to sell their shares and invest elsewhere. Ownership rights are readily tradable, and this provides a strong incentive for managers to focus on enhancing the value of the company.

Dividend announcement affects share prices positively (Miller & Rock, 1985; John & Williams, 1985). Dividend raise generates positive signals about current and future cash flows of the firm and negative vice versa (Gordon, 1959; Brunarski, Harman & Kehr, 2005). Depending upon dividend policy of the firm, it is paid either in the form of regular cash or additional stock and its payment pattern, i.e., quarterly, semiannually or annually also depends on a company's dividend policy. Many researchers have till date made attempts to study the impact of dividend announcements on share prices and concluded diverse results, some proposed positive relationship (Acker, 1999; Pettit, 1972; Aharony & Swary, 1980; Walter, 1956; Gordon, 1959). While on the other hand, some found a negative relationship (Easton & Sinclair, 1989; Loughlin, 1982). Many studies have examined market reactions to cash dividend announcements by analyzing abnormal returns around the announcements date. (Ang, 1975), (Gonedes, 1978) and Watts (1973) found that unexpected changes in dividends cause little or no abnormal returns.

The objective of the study was to identify the impact of dividend announcement on share price and conclusion based on the CSE. Section 2 of the study provides an overview of the relevant literature. Section 3 introduces the data and methodology while Section 4 presents the empirical results and their implications. Finally, Section 5 summarizes the conclusions of the study.

Literature Review

As the first economist who investigates the dividend signalling effect in the European market (Lonie et al., 1996), they investigated London stock exchange by using a sample of companies listed in the London Stock Exchange. They stated that in capital markets with information asymmetries, the market participants try to explain the managers'

announcements of dividends and earnings correctly, in order to make beneficial choices. Their results indicated that both dividends and earnings announcements affect the Share Prices. However, they found that earnings announcements have a more significant impact on them than Dividend Announcements. (Lonie et al.,1996). (Christie, 1994) identified all the reduction and omission announcements of dividends for a sample of firms listed on the New York Stock Exchange and on the American Stock Exchange for a period between 1967 and 1985. He provided evidence that future dividends have completely no significant relation to market reaction. Therefore, although studies which support the informational content hypothesis are by far more than the challengers, the dividend signalling effect on the American market remains an elusive issue.

Asimako et al (2007) explored the same hypothesis in the Athens Stock Exchange using a sample of listed firms, which distributed the lowest amount of dividend required or above the lowest required amount. Their outcomes suggest that when the listed companies in the Athens Stock Exchange declared the distribution of higher dividends than the compulsory amount publicly and when this increase was regarded by the market participants as an unexpected one, then there was a negative Stock Price reaction. According to suggestions of (Jensen & Johnson, 1995) dividend cut results in reduction in Share Price. The more interesting matter is that if capital markets are perfect, dividends have no influence on the Share Price. The impact of Dividend Announcement on Share Price provides evidence positively to the relationship between Share Prices and Dividend Announcements with an objective of that resolve problem which is faced by listed companies in Ghana Stock Exchange (Botchwey, 2014). This study was done by investigating dividend payments and its impact on Share Prices of Eco bank, Cal bank, and AngloGold Ashanti companies. These companies are selected out of the 36 companies listed in Ghana Stock Exchange. Using questionnaire as main data collection method, he found that there is a positive relationship between Share Prices and Dividend Announcement. Finally, he concluded that the Dividend Announcement has a positive impact on Share Prices.

An empirical study of stocks' Sensitivity to Dividend Announcements which is done by (Matharu & Changle, 2015) by testing semi-strong form of market efficiency is one of study that has included Dividend Announcements of 25 companies which are listed in Bombay Stock Exchange and employed Capital Assets Pricing Model (CAPM) and Paired T-test as methodologies. The finding of this study is that impact of Dividend Announcements, and Share Prices on selected companies vary with each other, and there are a significant difference pre and post-announcement period. The conclusion derived from this study is that to make wiser investment decisions, investors should follow dividend decisions of the company. It means there is a positive impact of Dividend Announcements on Share Prices. Effect of dividend on Stock Price in the emerging stock market analyzed empirically Stock Price reactions to the Dividend Announcement of the banking industry of Bangladesh (Ali & Chowdhury, 2010). This study was done by using Standard Event Study Methodology and selecting 25 listed banks in Bangladesh. According to this study the relationship between Share Prices and Dividend Announcements among these banks it has found that 11 banks behaved negatively, 6 banks behaved positively, and 8 banks showed no change in their findings. The T-test was also employed, and the result of this test is no significant Stock Price reaction to Dividend Announcement. Based on these findings, the study concluded that because of the contribution of insider trading and influencing factors in the capital market, Dividend Announcements does not generate a significant impact on Stock Prices.

In the Sri Lankan market, Stock Prices adjust in an efficient manner to new Dividend Announcement (Dharmarathne, 2013). This study includes a sample of 61 companies listed in CSE and 137 Dividend Announcements from 1999 to 2005. Especially, Market Model was employed to generate Abnormal Return and Standard Event Study Methodology was used to this study. The finding was that there is a considerable informational content of Dividend Announcements in CSE and Dividend Announcements are considered as favourable news to the investors. Dividend Announcements have a positive impact on Share Prices is the conclusion derived from this study. With an objective of examining the Stock Prices reactions to the Dividend Announcement in CSE performed a study with 30 companies listed in CSE as a sample. Data collection methods were CSE publications and CSE data library. To calculate AR, Market Model was used, and Standard Event Study Methodology was used by the researcher. Findings showed that the AAR and CAAR are positive around the Dividend Announcement date. These findings suggested that there is a positive relationship between Stock Prices and Dividend Announcements (Menike, 2014)

Methodology

The study investigates the relationship between dividend announcements on the share price. According to the above literature, a review study developed the following hypothesis.

H1: Dividend Announcement does not impact on Share Price.

H2: Dividend Announcement does impact on Share Price.

The population of this study consists of 295 companies listed in CSE. The sample consists of 60 Dividend Announcements throughout the analysis period, and that can be categorized into 47 companies which announced the

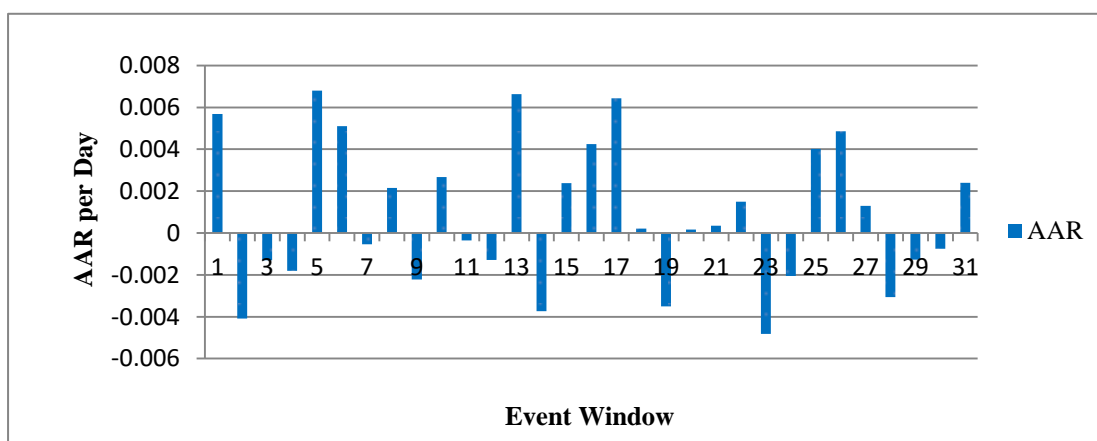
dividends throughout the study period. A company is selected as eligible for the study only when the following selection criteria are satisfied.

- I. The company should have been listed in the Colombo Stock Exchange throughout the study period.
- II. The daily and monthly stock price should be available, and the companies' shares were actively traded in the market

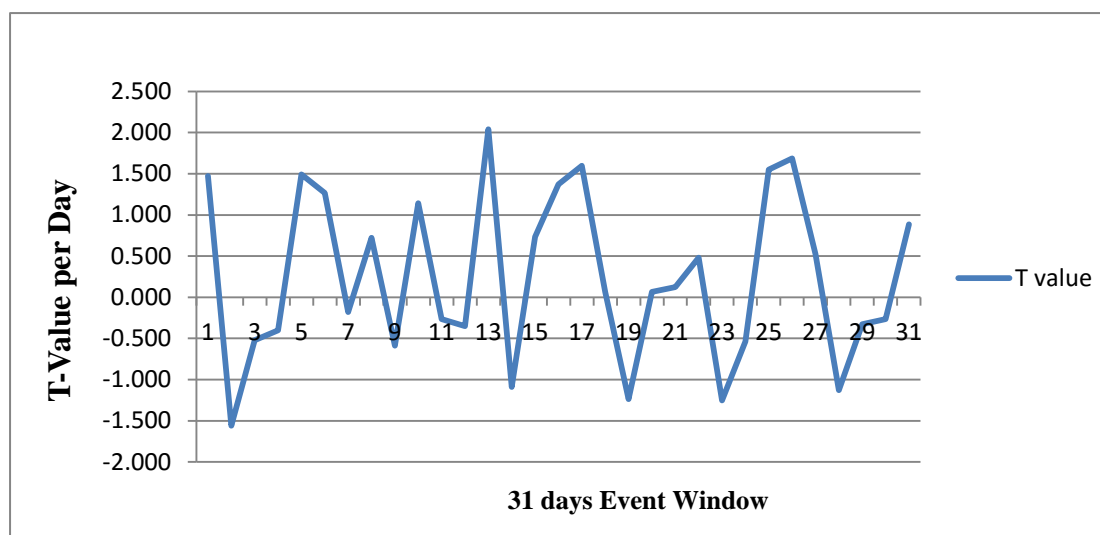
The research mainly gathered the Dividend Announcements details and Daily Dividend Stock Return details from the CSE data library. The collected data includes; Announcement dates for the period 2016-2017, Stock Prices for the test period (t-106, t+15) around each announcement day for every stock and Values of the ASPI (All Share Price Index) in the time window for each Dividend Announcement day. Impact of Dividend Announcements on Stock Prices is determined by using the Standard Event Study Methodology. After defining the Event, the stages which were discussed under Standard Event Study Methodology such as; Test Period, Comparison Period and Analysis period, have been chosen in accordance with this study. In this study consists of 31 days of Test Period as 15 days prior to Dividend Announcement date, 15 days after Dividend Announcement date and date of Dividend Announcement and 90 days of Comparison Period which is not include Test Period. Totally the Analysis Period consists of 122 days.

Result and Discussion

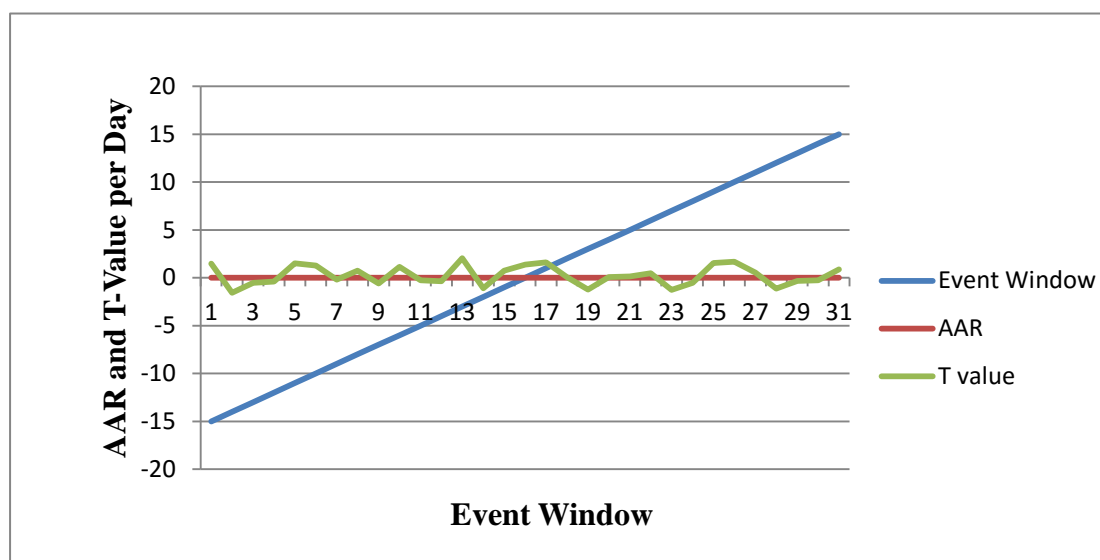
To test the relationship between dividend announcements on share price researcher employed different test to identify relationship clearly. According to the sample following figure shows that the AAR has not been widely changed over the 31 days Event Window. AAR Moves from 0.007 to -0.004 through the Event Window, and it is difficult to construct a linear relationship in connection with Event Date Abnormal Return and other surrounding days' Abnormal Returns. There are some positive Abnormal Returns and negative Abnormal Return around the Event Date.



T-values are values which are used to compare the sample mean(s) to the null hypothesis and incorporate both the sample size and the variability in the data. A T-value of 0 indicates that the sample results exactly equal the null hypothesis. The following figure reflected that, throughout 31 days Event Window, the behaviour of T-values. According to Figure, the T-values of AAR have been changed over the Event Window, and there are positive and negative t-values during the Event Window.



According to the T-Value, AAR and significance data (Appendix 01) the highest T-value during the Event window is 2.04. This T-value above the significant level that is 1.96 under the significant level 5%, and there are no any T-values which are greater than significant at 5%. More specially, T-value of the Event Date is 1.37, and it does not reflect significant at 5%. The Event Date of this Event Window is day four which represent the middle day of the event window. The following figure reflects AAR and T-Value behaviour for per day



There are two Hypotheses developed in this study based on literature, and those Hypotheses are evaluated using T-value statistics. According to the analysis result, T-values are used to test statistical significant at 5% and to arriving conclusion about the topic discussed throughout this study. According to the result, the null hypothesis is accepted, and the results have confirmed the theory developed by Miller and Modigliani that there is no relationship between a firm's Dividend Announcement and its Share Price. Though there is no impact on Share Prices that impact is in very less percentage. Therefore it cannot identify that the impact is significant. But there is no any impact of Dividend Announcement on Share Prices. Due to the Share Prices remain the same values after the announcement and before the announcement.

Conclusion

When examining the stock market reactions to Dividend Announcements, the result indicates that the Abnormal Return has not been changed surrounding the Dividend Announcement day. But the variation of Abnormal Return is not significant at all. The Shareholders of sample companies earned positive and negative Abnormal Returns around the announcement date. There is extensive empirical evidence on stock markets around the world. The first and final Dividend Announcements of 47 companies for two years period are considering this study. The Standard Event Study Methodology and Market Model are used to investigate the impact of Dividend Announcements and conclusion is

derived from T-Values. No significant abnormal return shows surrounding the Dividend Announcement day; 31 days and 3 days Event Windows. In this study statistical significant tested at 5% and becoming a conclusion based on this value. Based on the descriptive analysis, the Dividend Announcement also doesn't show a significant impact on Share Prices. Therefore the conclusion of this study is the Dividend Announcements do not lead to positive or negative market reactions towards Market Price that do not support to signalling theory and the all findings accepted the null hypothesis according to the analysis result. This research is conducted by using a small sample of 47 companies for two years period and considering only first and final Dividend Announcements. But more strong evidence could be observed by using a larger sample for a long period and considering all type of Dividend Announcement as an interim dividend, cash dividend, and special Dividend Announcements. As mention in chapter two, Dividend Announcement is not the one, and the only factor affect Share Prices. This research is conducted under the assumption of other factors are remained unchanged. By using more sophisticated statistical techniques to control the impact of other factors will be obtained most reliable results. This study is one of the researches in Sri Lankan Capital Market based on quantitative factors for a few years. So, the findings of this research can be used for qualitative discussion and requirements of future studies. It would be beneficial for future studies to focus on determinants of dividend payouts, dividend policy in CSE.

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Appendix

Event Window	AAR	T value	Significant at 5%
-15	0.006	1.471	
-14	-0.004	-1.560	
-13	-0.001	-0.523	
-12	-0.002	-0.400	
-11	0.007	1.493	
-10	0.005	1.266	
-9	-0.001	-0.181	
-8	0.002	0.723	
-7	-0.002	-0.589	
-6	0.003	1.142	
-5	0.000	-0.267	
-4	-0.001	-0.350	
-3	0.007	2.040	**
-2	-0.004	-1.090	
-1	0.002	0.733	
0	0.004	1.372	
1	0.006	1.596	
2	0.000	0.066	
3	-0.004	-1.237	
4	0.000	0.065	
5	0.000	0.123	
6	0.001	0.483	
7	-0.005	-1.252	
8	-0.002	-0.537	
9	0.004	1.549	
10	0.005	1.687	
11	0.001	0.524	
12	-0.003	-1.128	
13	-0.001	-0.326	
14	-0.001	-0.265	
15	0.002	0.885	

Company's Code	Alpha	Beta
ARPI-N-0000	0.0041	2.1061
ASPH-N-0000	-0.0003	2.3032
CABO-N-0000	0.0013	0.2703
CFLB-N-0000	0.0004	1.4806
CITH-N-0000	-0.0014	1.4307
COCO-N-0000	0.0003	0.6233
ESL-N-0000	0.0058	0.6933
GEST-N-0000	0.0033	-0.7553
LALU-N-0000	0.0022	0.3643
LPRT-N-0000	0.0033	-1.3789
MEL-N-0000	-0.0002	0.5469
RAL-N-0000	-0.0005	0.6757
RENU-N-0000	0.0014	0.4462
RHL-N-0000	0.0002	1.2812
SHAW-N-0000	0.0033	-0.4827
SIL-N-0000	0.0006	0.5965
SLND-N-0000	-0.0011	0.1409
ASIY-N-0000	0.0005	0.8226
ASPH-N-0000	0.0012	0.0196
AUTO-N-0000	0.0001	0.1445
CABO-N-0000	0.0014	0.2166
CFLB-N-0000	0.0004	1.4996
CINS-N-0000	0.0032	-0.1416