ABSTRACT

Final dividend announcements are important corporate events looked forward to by the investing community. Dividend announcements indicate a firm’s future prospects and earning abilities. Dividends are looked forward to with great eagerness and interest by finance experts and the investing community as these are considered an important signalling device whereby a firm’s future prospects can be assessed. Dividend announcements are generally associated with positive share price reactions. The popularity of these actions has increased over the years, especially in the Indian domain. Despite the growth in dividends, there have not been many studies about whether such announcements imply gains to stockholders.

The purpose of this study is to investigate the dividends phenomenon intensely and check whether it is possible to earn an above normal return on a publicly traded stock when the firm announces final dividends. Previous international studies suggest that a dividend announcement sends positive signals about the firm’s future, thereby significantly increasing the firm’s stock price. Positive signal attract a new breed of investors, thus driving up the demand for the firm’s stock.

As per the efficient market hypothesis, prices adjust quickly and fully to new information if the announcements contain relevant information to investors. Hence, it is not possible for investors to outperform the market by using public information. The information impounds into the stock prices so quickly that an investor cannot earn more than the normal risk adjusted return.

The main purpose of study is to contribute to a better understanding of the Indian stock market based on empirical evidence on the semi-strong market efficiency. The final dividend effects of firms and their impact on the stock market prices are analysed. The investigation is based on the event-study methodology. All companies making final dividend announcements between 2005 and 2013 in the 6 sectors listed on Bombay Stock Exchange—Auto, Banking, Consumer Durables, Fast Moving Consumer Goods, Health Care and Information Technology are chosen for the study. A total of 518 final dividend announcements of 69 companies spread across the above 6 sectors are identified and examined. A few Indian studies provide insights into events such as dividend pay-outs, bonus issues, rights issues,
stock splits, mergers and acquisitions of some sectors for some years. Very few studies in the Indian context have analysed the effect of dividend payments on stock prices behaviour. Perhaps, no research has been done covering 6 sectors for the period spread over 9 years between 2005 (the launch of sectoral indices) and 2013. This research is an attempt to understand the effects of the final dividends declaration on stock prices. As the research covers a broad event window of 61 days and an estimation period of 252 days prior to the event window, the investors will get a fair idea on whether past prices have any impact at all on the prices post the event announcements. Stock price relative range has been used in the study as this is a better platform to have an understanding of stock price variation around dividend announcements.

The results provide some evidence about the information content of dividends, as abnormal returns ensued to investors on announcement day. However, the study results fail to support the semi-strong form efficient market hypothesis in BSE. There are instances when markets did not react immediately and wholly to new information. In many cases, negative returns were found in the 61 day event window indicating that the investors expectations were more than the actual announcements.