An Event Study of Stock Splits in the Colombo Stock Exchange

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09/8505

Degree of Master of Science in Financial Mathematics

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DECLARATION OF THE CANDIDATE

I hereby certify that this dissertation does not incorporate acknowledgement of any material previously submitted for a degree or Diploma in any University, and to the best of my knowledge and belief it does not contain any material previously published or written by another person or myself expect where due reference is made in the next text.

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DECLARATION OF THE SUPERVISOR

I have supervised and accepted this dissertation for the submission of the degree.

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ABSTRACT

A stock split is a decision by the company's board of directors to increase the number of shares outstanding to its current shareholders. This is considered purely a cosmetic event not having a direct impact on the company's valuation. However, empirical findings show that the value of the firm increases when it announces a stock split. The current study employs the standard event study methodology to identify the abnormal returns associated with a stock split announcement. In Sri Lanka, the Companies Act No. 07 of 2007 brought in provisions for splitting of shares. The entirety of announcements from 2008 to November 2012 has been considered for the study. This is a total of 80 announcements relating to 66 companies. Three normal return benchmarks, namely the market-adjusted model, mean-adjusted model and the market model have been used in an attempt to provide a methodological triangulation of results. The study finds significant abnormal returns on the day of announcement that exceed 6%. Announcements that are contaminated by other contemporaneous firm specific announcements show lower abnormal returns compared to pure stock split announcements. Also there is a positive relationship between the split ratio and the abnormal returns. Finally, abnormal returns experienced during the boom period exceed that of the bust period. The signaling hypothesis, liquidity hypothesis, managerial entrenchment hypothesis and the neglected firm hypothesis all support these findings. The study finds that it is not possible to make arbitrage profits after the first day relative to the announcement day and due to the quick adjustment of prices this study concludes that the CSE is semi-strong form efficient with regard to stock split announcements.

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