5. CONCLUSION

This study analyzes the information content of stock split announcements in the Colombo Stock Exchange on and around the announcement day. A total of 80 announcements relating to 66 companies, which is the entirety of announcements up to November 2012 since stock splits were introduced by the Companies Act No. 7 of 2007. The standard event study methodology is used to identify the abnormal returns associated with a stock split announcement. 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 findings conclude that there are positive returns associated with the announcement of stock splits. Despite the absence of explicit costs (such administrative costs when making a stock split in the CSE) firms concerned about their reputation will use stock split announcements as a signaling mechanism only when they have favorable information about the firm. This supports the signaling hypothesis as well as managerial entrenchment hypothesis.

Stock split announcements that are not contaminated by other contemporaneous firm specific announcements yield a higher return compared to contaminated events. This could be due to investors not being able to properly understand the information content of several announcements. The study also finds a positive relationship between the split ratio and abnormal returns. This could be due to the increased liquidity that would follow the stock split and supports the liquidity hypothesis. Finally, analyzing the response to split announcements over different market conditions, namely the boom period and bust period, this study finds that the abnormal returns were greater during the boom period while the positive abnormal returns experienced during the bust period reverses over the event window under both the market model and the mean-adjusted model.

Presence of abnormal returns on days leading to the announcement day indicates a leakage of information and supports strong form efficiency. Investors holding stocks, that make stock split announcements, a few days before announcement stand to gain substantially high abnormal returns. Abnormal returns on the event day are significant and exceed 6%. The decision to split the stock is announced through the CSE and will be made available on the CSE website on the event day itself. This information will be conveyed to market participants through their respective brokers and also appear on the CSE Daily publication that is available the following day. Due to this transmission lag, there would be some market participants who get the information late. However, abnormal returns as a result of this inefficiency are short lived and plateau out after the first day relative to the announcement. Overall, the significance of the abnormal returns one day after announcement is very low. Hence the abnormal returns are not persistent as the market quickly incorporates the new information into the prices. Purchasing two days after the day of announcement will not result in significant abnormal returns. Thus in general, it is not possible to make arbitrage profits based on the announcement information after the first day relative to the announcement. This evidence supports semi-strong form efficiency of the CSE.