STOCK MARKET RESPONSE TO STOCK SPLIT AND POLITICAL INFORMATION IN SRI LANKAN STOCK MARKET: AN EVENT STUDY APPLICATION

S.RAMESH*, T VELNAMPY *, B.NIMALATHASAN*

Introduction

This study examines properties of daily stock returns and how the particular characteristics of these data affect event study methodologies for assessing the share price response of firm-specific informational events and market related informational events. Event studies are joint tests of market efficiency and the model of expected rates of return used in estimating abnormal returns. " Initially event studies were undertaken to examine whether markets were efficient, in particular, how fast the information was incorporated in share price. According to the Kothari (2001) one infers whether an event, such as an earnings announcement, conveys new information to market participants as reflected in changes in the level or variability of security prices or trading volume over a short time period around the event in an event study. The event study method is developed as a statistical tool for solving questions like this, which are focused on abnormal returns (ARs). The general applicability of the event study methodology has led to its wide use and nowadays it is one of the most frequently used analytical tools in financial research (Luoma, 2011). The link between stock splits and stock return has been an interesting topic for researchers. It is evident from the theoretical perspectives that while stock split announcement increases the number of shares of a company, it decreases the price per share. A stock split usually takes place after an increase in the price of the stock, and it carries a positive stock price reaction (Carlos and Frank, 2009). However, stock splits usually increase stock prices with announcement (Gunnathilaka and Kongahawatte, 2011). Financial economists have sought to understand why markets react to stocks splits, since a stock split appears to be merely a cosmetic transaction that increases the number of shares outstanding. In a stock split, shareholders do not receive any tangible benefit.

Political event is one of the crucial factors influencing the operation of a country's stock market as widely claimed by numerous studies. The political events adversely affect the confidence of both domestic and foreign investors as the volatility of stock market is increased which lead to the uncertainty of the investment expected cash flows(Kongprajya, 2010). The example of empirical case of the impact of political event on the whole economy is the sudden and devastating tragedy of September 11th, 2001 in the US. It can come in many forms such as introduction of government policy, government election, civil war, terrorists and suicidal bombing attack, political pressure group, peace talks, government budget, corruption case, major labour union protest and natural disaster. These political incidents may have both favorable and unfavorable effects on stock prices of listed companies in the Sri Lankan stock market. The political situation in Sri Lanka has a large impact on the foreign and domestic investors' perception to buy shares.Therefore, the aim of this study is to analyze in the extent which a company's stock price would reflect the announcements of stock splits and political incidents according to the semi strong form efficiency which states that stock prices reacts so fast to all public information and no investor can earn an abnormal return after the announcement is made. Information is the key to the determination of the share prices and the key issue of the efficient capital market (Keane, 1986). An efficient market is one, where the stock prices quickly and fully reflect all available information about the assets.

Department of Accounting, Faculty of Management Studies & Commerce, University of Jaffna, Sri Lanka