

## **A STUDY ON THE IMPACT OF DIVIDEND ON STOCK PRICES**

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### **ABSTRACT**

The investment decision is influenced by many factors of which one such factor is return. The shareholders may get return in the form dividend which affects the share prices. The behavior of stock prices is unpredictable as price movement for different activities will move in different ways. The stock price influence activities can be divided into Economic and corporate activities. The impact of economic activities will be more or less same on all the stock prices while impact of corporate action varies from one stock to the other. Dividend payment is one of the important corporate actions that will have an impact on the behavior of stock prices. This research highlights the impact of dividend payment on the behavior of stock prices and their abnormal returns. To understand this behavior, 120 stocks have been randomly picked which have paid the dividend in 2016. The researchers have used popular event window study and abnormal returns.

**Keywords:** Abnormal returns, Announcement date, corporate actions, Dividend payment, Economic Activities, Event window, Stock price behavior.

## **Introduction:**

The shareholders are the real owners of the business who decide whether hold the shares of the company or sell the shares based on returns. The decision depends on corporate action. The corporate action may result in some benefit to the shareholders as there is a relationship between corporate actions and its impact on share price. The dividend is one important event of corporate action which may have direct impact on the shareholder's wealth.

According to the dividend signaling theory, a company decides to announce its dividend payout policy to signal the market that the firm is now processing future prospects, which will result in changing its stock prices. The market price of a security is the most recent price at which the security is traded. Dividends affect the price of the underlying stock in three primary ways. While the dividend history of a given stock plays a general role in its popularity, the declaration and payment of dividends also has a specific and predictable effect on the market prices. This article tries to understand the impact of dividend announcement on stock price and its actual returns & abnormal returns. Dividend announcement may or may not impact the stock price of the companies and stock prices may undergo positive or negative change. This article explains how dividend announcement impacts the share price and it because the abnormal returns with comparison with market index. These studies are generally called Event window studies.

## **LITERATURE REVIEW:**

In published literature, there is no consensus evidence on the effect of dividend announcement on the stock prices in the world, but it can be observed that there are mixed empirical evidences on the dividend effect.

(Gordon, 1959), (Arif & Finn, 1986), (Stevens & Jose, 1992), found significant positive effect on the dividend announcement. Mark et. al. (1984) examined the valuation effects of stock dividend announcements that, there is a significant increase in a firm's stock price at the announcement in general. (Ball & Brown, 1968) have documented Post-earnings announcement drift; it is an indication to show the tendency for the movement of stock prices for several days or several months. Based on their study; they found, investors have earned abnormal profit at the time of annual report and dividends. They have examined three different patterns (1) the earnings and dividends after closing market, (2), dividends announced before and earnings announcement after closing market, (3), earnings announced before and dividends announcement after closing market. Based on abnormal returns, they found evidence that support the overall hypothesis and observed that investors pay attention to the relative timing of intraday announcement. (Denis & Atulya Sarin, 1994) arrived at results that seek to explain the positive association between dividend change announcements and stock price reactions. (Obaidullah, 1992) investigated efficiency of the Indian stock markets by analyzing the effect of stock dividend announcements using event study methodology. He finds that the entire adjustment in the stock prices due to announcement occurred much before the announcement itself and prices declined in the subsequent period. The study also found that the market reaction was nowhere related to the size of the stock dividend. In addition, abnormal returns were noticed when the share went ex-bonus three months after the date of announcement. Some of the researchers found indifferent evidences on the dividend announcement (Pichardo & Bacon, 2009) and (Mahadevan & Saravanakumar, 2011). (Kang & Diltz, 2000) examined the stock returns of 175 divestitures and 21 acquisitions between 1990 and 1994 and found abnormal positive returns on and before the announcement date, that indicated, information flow have already entered in the market. (Baker & Wurgler, 2004), based on the theory of dividend, they proposed that dividends are determined based on the investor demand. The decision to pay dividends is based on investor payment of premium. (Thirumalvalavan & Sunita, 2005) studied significance of firms' announcement of stock repurchases. The overwhelming reason given for stock repurchase announcements has been reversed a trend of declining stock prices. (Parul Bhatia, December 2010), witnessed that the stock price is determined from the positive significant dividend effect. The stock returns did not change drastically but the announcements did affect the stock prices, with the significant t-test values.

On the contrary, (Loughlin, 1982) and (Easton & Sinclair, 1989) found negative effect on the dividend announcement. Md. Hamid Uddin, (2003), studied 137 companies that paid dividend listed in Dhaka Stock Exchange, and he found that investors did not gain returns from dividend announcement and also found that 30 days' prior the dividend announcement, shareholders lost about 20 per cent. Bacon (2009) studied the effect of announcement of Lehman Bankruptcy on 15 stock brokerage firms. He studied risk adjusted returns before and after announcement and found that the stock prices had already decreased 24 days prior to the announcement and continued to drop for several weeks.

### **OBJECTIVES:**

- 1) To find out the intercept, slope and standard error of the each stock with market index.
- 2) To calculate the expected return, abnormal return and average abnormal return of each stock.
- 3) To test the significance of average abnormal return.

### **HYPOTHESIS:**

**H<sub>0</sub>:** Dividend announcement date has no significant impact on average abnormal returns. ( $d = 0$ )

**H<sub>a</sub>:** Dividend announcement date has a significant impact on average abnormal returns. ( $d \neq 0$ )

### **RESEARCH METHODOLOGY:**

The research design applied for this study is descriptive in nature and is based on secondary data. The purpose of this study is to find out the effect of dividend announcement date on share price abnormal returns. This done using 21 days window period which includes 10 days before announcement, announcement day and 10 days after announcement. For the year 2016, 120 companies were randomly selected for analysis which includes different capitalization stocks and different dividend percentages. The 120 sample units were stratified in two different ways.

Stratification I: This was based on market capitalization creating three strata – large, medium and small caps.

Stratification II: This was done according to the amount of dividend declared leading to four sub strata i.e 1 to 99%, 100-199%, 200-399% and above 399%.

The purpose was to cross examine the impact from these two angles separately. The analysis looks at the overall picture during the window period, without reference to any stratification.

The study uses two-phase approach in order to know the impact of dividend announcement on stock prices. The first phase calculates the intercept, slope and standard error based on the 252days pre returns on stocks and market index. The second phase evaluates the expected returns of stocks using Simple Regression Model and these estimated values are used to calculate stocks abnormal returns around the event window. Here, dividend announcement date is day 0. Pre-announcement duration includes 10 trading days prior to the dividend announcement date, i.e., days -10 to -1. Post announcement period includes 10 trading days after the dividend announcement i.e., days +1 to +10, thus event window of 21 trading days considered (including day 0 as the event day). The calculated abnormal returns are averaged across stocks to calculate average abnormal returns (AARs).

Simple Regression Model can be expressed as follows

$$\text{Expected Return} = ER = a_i + b_i R_m \text{----- (1)}$$

where,

ER = Expected return on stock 'i'

$a_i$  = Intercept of a straight - line or alpha coefficient of ith stock.

$b_i$  = Slope of a straight - line or beta coefficient of i th stock.

$R_m$  = Expected return on index (BSE 500 Index used in this study)

The abnormal returns are computed using the following model:

$$AR = R - ER \text{----- (2)}$$

where, R = Actual Returns

Each stock abnormal return is averaged for each day around the event day i.e., 10 days before announcement and 10 days after the announcement day. The AAR is the average deviation of actual returns of a stock from the expected returns.

Average abnormal returns (AARs) are calculated using following formula:

$$AAR = \frac{\sum_{i=1}^N ARI}{N} \text{----- (3)}$$

where,

i = the number of securities in the study;

N = total number of securities in the class (group).

Parametric t test was used to access the significance of AARs.

t values are calculate as fallows

$$t = \frac{AAR}{\sigma(AAR)} \text{----- (4)}$$

AAR = Average abnormal return

$\sigma$  (AAR) = Standard error of average abnormal return

The standard error is calculated as  $SE = \frac{\sigma}{\sqrt{N}}$  ----- (5)

## ANALYSIS & INTERPRETATION:

**Table 1: All the Selected Stocks & Large Cap Stocks AAR, SE and t values around event window.**

All Stocks (N = 120)				Large Cap Stocks (N = 41)		
Day	AAR	SE	t Values	AAR	SE	t Values
-10	0.0515	0.1377	0.3739	0.2196	0.1717	1.2795
-9	0.0065	0.1583	0.0414	0.0432	0.2680	0.1611
-8	-0.2357	0.1273	-1.8511*	-0.0957	0.2034	-0.4708
-7	0.0591	0.1461	0.4045	0.2017	0.2441	0.8261
-6	-0.0741	0.1631	-0.4544	0.1096	0.3312	0.3308
-5	-0.0120	0.1257	-0.0954	-0.1933	0.2354	-0.8212
-4	-0.0711	0.1491	-0.4768	-0.0173	0.2471	-0.0702
-3	0.0385	0.2357	0.1633	-0.0465	0.2796	-0.1663
-2	0.0140	0.1742	0.0803	-0.1205	0.2690	-0.4479
-1	-0.0068	0.1444	-0.0474	0.2344	0.2192	1.0692
0	-0.1590	0.2859	-0.5562	0.3288	0.4743	0.6934
1	-0.2284	0.3012	-0.7583	0.6847	0.7542	0.9078
2	0.0307	0.1812	0.1696	0.1626	0.3441	0.4725
3	-0.1887	0.1382	-1.3653	-0.2327	0.2698	-0.8627
4	-0.0306	0.1517	-0.2020	0.0002	0.1792	0.0010
5	-0.2092	0.1383	-1.5125	0.0801	0.2324	0.3449
6	-0.1205	0.1140	-1.0563	0.0340	0.1650	0.2060
7	-0.1153	0.1320	-0.8734	-0.2611	0.2241	-1.1651
8	-0.1202	0.1702	-0.7062	-0.3446	0.4497	-0.7663
9	0.1882	0.1575	1.1949	0.1363	0.2738	0.4978
10	-0.1883	0.1429	-1.3183	-0.1798	0.3097	-0.5803

\*Significance @ 10%, \*\* Significance @ 5% and \*\*\* Significance @ 1%

Table 1 exhibits all samples AARs and large capitalization stocks AARs. In all sample returns it was highest positive AAR on 9th day is 0.1882 and lowest negative return observed on -8th day before announcement day is -0.2357. It is also shows that out of 21 days event window only seven positive abnormal returns and 14 negative abnormal returns and event day it observed negative abnormal return is -0.1590. Only on -8th day before dividend announcement it observed t calculated value is significant @10% level and remaining day's t calculated values are not significant. So, it can be said that dividend

announcement does not lead any abnormal returns during 21 days window period other than -8th day. Investors will have more interest on large capitalization stocks, because it will have more liquidity and more volume of trade, so investors will have more interest on their dividend announcement. Here, highest positive abnormal return is 0.6847 on 1st day after event day and lowest negative abnormal return is -0.3446 on 8th day after announcement. Only 9 negative abnormal returns and remaining 12 days it is positive abnormal returns during event window and also observed more positive abnormal returns from -1 to +2 event days. But AARs are not significant any day during event window, which means dividend announcement, is not impacting stocks price returns.

A glance at table1, reveals some interesting aspects about the overall scenario. The largest positive AAR was 0.188 (Day9) while it was lowest at -0.2357 (Day-8). The window period recorded 7 positive returns as against 14 negatives including a return of -0.1590 on day0. Also only the value on day -8 was statistically significant at 10% level significance. Thus we may not infer that dividend announcement does not induce significantly abnormal returns during the window period.

In view of greater liquidity and volume of trade, investors are expected to focus more on large capitalization stocks and the associated dividends. After the announcement date the very next day (day1) recorded the largest return at 0.6847, which then tapered down turning occasionally even negative. In all, 9 negatives recorded against 12 positives. Surprisingly none of the observations were statistically significant.

**Table 2: Medium & Small Cap Stocks AAR, SE and t values around event window.**

Medium Cap Stocks (N = 39)				Small Cap Stocks (N = 40)		
Day	AAR	SE	t Values	AAR	SE	t Values
-10	-0.1639	0.2422	-0.6766	0.0562	0.2906	0.1933
-9	-0.3002	0.2629	-1.1421	0.2503	0.3118	0.8028
-8	-0.4067	0.2043	-1.9909*	-0.1988	0.2663	-0.7466
-7	-0.1704	0.2311	-0.7375	0.2780	0.3174	0.8759
-6	-0.0273	0.2702	-0.1011	-0.1409	0.3066	-0.4595
-5	0.0894	0.2236	0.3996	0.1727	0.2275	0.7592
-4	-0.2698	0.2709	-0.9961	0.0770	0.2808	0.2741
-3	0.1326	0.2794	0.4747	0.0225	0.6051	0.0372
-2	0.2080	0.3428	0.6069	0.0954	0.3502	0.2724
-1	0.0279	0.2729	0.1021	-0.1873	0.2928	-0.6397
0	-0.3996	0.5755	-0.6944	-0.4636	0.4800	-0.9658
1	-0.9886	0.4297	-2.3004**	-0.5527	0.3220	-1.7164*
2	0.2115	0.3505	0.6033	-0.2931	0.2766	-1.0595
3	-0.2527	0.2081	-1.2139	-0.1438	0.2627	-0.5472
4	0.1293	0.2923	0.4422	-0.4347	0.2239	-1.9420
5	-0.6346	0.2815	-2.2540**	-0.1014	0.2138	-0.4741
6	-0.2760	0.2413	-1.1440	-0.1992	0.1862	-1.0701
7	0.0619	0.2741	0.2258	-0.1606	0.2046	-0.7850
8	0.1200	0.2227	0.5388	-0.0430	0.2126	-0.2024
9	0.0563	0.1723	0.3264	0.3020	0.3709	0.8142
10	-0.2418	0.2132	-1.1343	-0.1614	0.2455	-0.6576

\*Significance @ 10%, \*\* Significance @ 5% and \*\*\* Significance @ 1%

Table 2 exhibits, medium and small capitalization stocks, where medium capitalization will have moderate liquidity and moderate value trade and small capitalization will have less liquidity less value trade, these factors may motivate investors to have less interest on medium and small cap stocks compare to large caps. AARs observed in medium cap stocks 0.2115 is highest positive return on 2nd day after announcement and -0.9886 is lowest negative return on 1st day after announcement day and also observed 12 days negative returns and 9 days positive abnormal returns. Around event day and

event day also shows negative abnormal returns. Medium cap stocks calculated t values significant @ 10% level on -8th day before announcement, significant @5% level on 1st day and 5th day after announcement day and remaining all days during 21 day window t values are not significant.

In small cap stocks, highest positive abnormal return observed is 0.3020 on 9th day after announcement and lowest negative abnormal return is -0.5527 on 1st day after announcement. Out of 21 days window 13 days are negative abnormal returns and only 7 days are positive abnormal returns and around event day & after event days also negative abnormal returns observed. Only on 1st day after announcement day calculated t value is significant and other days calculated values are not significant.

A few pertinent points may be made on table 2 which concerns medium cap stocks which are expected to arouse only moderate responses in view of moderate/low liquidity. The highest return for moderate stocks at 0.2115 was over Day2 which was preceded by the lowest -0.9886 on Day1. There were in all 12 negatives as against 9 positives during the entire period including a negative on -0.3996 on event day. However day8 recorded a significant value 1 at 10% level and similarly o Day1 (at 5% level) and Day5 also (at 5% level). None of the other values were statistically significant.

Table 3 display average abnormal returns and the calculated values of whose stocks dividend percentage 1% - 99% (Low dividend) and 100% - 199% (Moderate dividend). In low dividend percentage group on 9th day after announcement it is observed 0.5565 is highest positive abnormal return and -0.6808 is lowest negative abnormal return on 0th day (Event day). Out of 21 average abnormal returns 11 positive abnormal return and 10 negative abnormal returns and also observed around event day (-1, 0, +1) negative abnormal returns. On -10th day before announcement calculated t value is significant @10% level and on 3rd day after announcement t value is significant and other calculated t values are not significant. In moderate dividend percentage stocks abnormal return is 0.3393 highest positive returns and -0.4316 is lowest abnormal return. 13 days observed negative abnormal return and 8 days positive abnormal return in total 21 days window, but event day and previous days of event day observed positive returns. Except on -10th day before announcement all other days calculated t values are not significant.

**Table 3: Low & Medium Dividend percentage stocks AARs, SE and t values around event window.**

Dividend Percentage 1% to 99% (N = 35)				Dividend 100% to 199% (N = 30)		
Day	AAR	SE	t Values	AAR	SE	t Values
-10	-0.5994	0.3235	-1.8527*	0.3393	0.1790	1.8951*
-9	0.0201	0.3114	0.0645	-0.0920	0.2813	-0.3270
-8	-0.3035	0.2501	-1.2137	-0.0641	0.2544	-0.2520
-7	0.1586	0.3456	0.4590	-0.0894	0.2378	-0.3761
-6	0.0189	0.3748	0.0503	-0.2633	0.2553	-1.0312
-5	0.2811	0.2655	1.0591	-0.0184	0.2696	-0.0681
-4	-0.2153	0.2880	-0.7475	-0.3884	0.2300	-1.6885
-3	0.2110	0.6711	0.3144	0.0201	0.2909	0.0691
-2	0.1524	0.3971	0.3839	0.2067	0.3711	0.5569
-1	-0.0285	0.2928	-0.0975	0.1387	0.2984	0.4647
0	-0.6808	0.5899	-1.1540	0.0879	0.8086	0.1087
1	-0.5068	0.4937	-1.0264	-0.3609	0.5372	-0.6717
2	0.1302	0.3556	0.3662	-0.4316	0.3910	-1.1039
3	-0.4554	0.2063	-2.2080**	-0.1347	0.2745	-0.4908
4	0.2258	0.3837	0.5885	-0.2250	0.2928	-0.7682
5	-0.2919	0.2746	-1.0630	0.1961	0.2874	0.6823
6	0.0786	0.1994	0.3940	-0.0868	0.2265	-0.3831
7	-0.1004	0.2240	-0.4483	-0.1099	0.3215	-0.3419
8	0.0041	0.2269	0.0181	0.1874	0.3087	0.6072
9	0.5565	0.3991	1.3943	-0.0942	0.2817	-0.3344
10	-0.2188	0.2212	-0.9891	0.3303	0.3252	1.0157

\*Significance @ 10%, \*\* Significance @ 5% and \*\*\* Significance @ 1%

Looking at table 3 some interesting facts are known. Pertaining to low and medium dividend stock. The AAR shows -0.6808 on day0 which is lowest, similarly it was 0.5565 being highest on day9. There were in all ten negatives as against 11 positives during the whole period in the dividend percentage of 1 to 99%. However there were 13 negatives as against 8 positives in dividend percentage of 100 to 199%. Table 4 exhibits average abnormal returns of which stocks dividend percentage 200% to 399% (High dividend stocks) and above 400% percentage dividend (Very high dividend stocks). In high dividend percentage stocks 0.5585 is highest positive abnormal return on -10th day of before announcement day and -0.6335 is lowest abnormal return on 10th day after announcement day. Out of 21 days window period only 6 days are positive abnormal returns and remaining 15 days it shows negative abnormal returns, but contrast other classes' event day it observed positive abnormal return. Only on -10th day before announcement and 10th day after announcement calculated t values are significant @5% and @10% respectively and remaining other days calculated t values are not significant. In very high dividend percentage group 14 days average abnormal returns are in negative and 7 days returns are in positive. Highest positive abnormal return is 0.7214 on 1st day after announcement and -0.6785 is lowest negative abnormal return on 8th day after announcement day. In this classification, on event day it is negative return, but before and after event day it is positive abnormal returns. Out of 21 days average abnormal return calculated t values 20 days values are not significant and only on -8th day significant @10% level.

**Table 4: High & Very High Dividend Percentage Stocks AARs, SE and t values around event window.**

Dividend Percentage 200% to 399% (N = 29)				Dividend 399% above (N = 26)		
Days	AAR	SE	t Values	AAR	SE	t Values
-10	0.5585	0.2323	2.4044**	0.0302	0.2771	0.1091
-9	-0.0774	0.2532	-0.3056	0.1956	0.4298	0.4551
-8	-0.1564	0.2871	-0.5448	-0.4319	0.2279	-1.8953*
-7	0.3842	0.2956	1.2998	-0.2661	0.2346	-1.1344
-6	-0.0095	0.3155	-0.0300	-0.0531	0.3365	-0.1577
-5	-0.1321	0.1710	-0.7728	-0.2652	0.2766	-0.9587
-4	0.4306	0.3448	1.2487	-0.0703	0.3160	-0.2226
-3	-0.2048	0.3666	-0.5588	0.0989	0.3323	0.2977
-2	-0.3323	0.2726	-1.2191	-0.0084	0.3045	-0.0276
-1	-0.3657	0.2964	-1.2338	0.2547	0.2500	1.0188
0	0.1373	0.3836	0.3580	-0.0720	0.2792	-0.2579
1	-0.6069	0.5319	-1.1411	0.7214	0.8718	0.8275
2	0.2646	0.3290	0.8043	0.1693	0.3697	0.4581
3	-0.2376	0.3526	-0.6739	0.1627	0.2766	0.5882
4	0.0327	0.2270	0.1440	-0.2223	0.2235	-0.9945
5	-0.3321	0.2316	-1.4342	-0.4286	0.3070	-1.3958
6	-0.3073	0.2505	-1.2268	-0.2189	0.2485	-0.8810
7	-0.1527	0.2755	-0.5541	-0.0998	0.2401	-0.4155
8	-0.0878	0.2860	-0.3071	-0.6785	0.5426	-1.2504
9	0.0946	0.2685	0.3524	0.1228	0.2139	0.5743
10	-0.6335	0.3319	-1.9089*	-0.2492	0.2411	-1.0337

\*Significance @ 10%, \*\* Significance @ 5% and \*\*\* Significance @ 1%

Table 4 which speak about high and very high dividend around dividend announcement dates. The largest positive AAR was 0.5585 on day -10. While it was -0.6335 and day 10. The window period recorded 7 positive returns as against 14 negatives including a return of 0.1373 on day0. Similarly the largest AAR at 399% and above was noted at 0.7241 on day1 while it was -0.6785 on day8. At glance there were 8 positives and 13 negatives in all.

In brief, highest positive abnormal return is 0.7214 on 1st day after announcement day in very high dividend percentage group, fallows 0.6847 on 1st day after announcement day in large cap group and lowest negative

abnormal return is -0.9886 on 1st day after announcement day in medium cap group, follows -0.6346 on 5th day after announcement day in medium cap group. Most of the highs and lows happen only after announcement date, so investor may react to the dividend announcement but it is not proving statistically significant most of the days during event window and in all most all stratifications (Groups).

The scenarios in table 1 to 4 are summarized in gist form in table 5.

**Table 5: The scenarios at gist**

Case	N	Before Event day		After Event Day		On Event day	Min	Max
		+Ve	-Ve	+Ve	-Ve			
Stratification I: Capitalization								
I. Small	40	7	3	1	9	-	-0.5527	0.302
II. Medium	39	4	6	5	5	-	-0.634	0.2115
III. Large	41	5	5	6	4	+	-0.3446	0.6847
Total	120	16	14	12	18		-0.5527	0.6827
Stratification II: Dividend Percentage								
IV. 1 to 99%	35	4	6	5	5	-	-0.6808	0.5565
V. 100 to 199%	30	4	6	3	7	+	-0.4316	0.3393
VI. 200 to 399%	29	3	7	3	7	+	-0.6069	0.5585
VII. Above 399%	26	4	6	4	6	-	-0.6785	0.7214
Total	120	15	25	15	25		-0.6808	0.7214
Overall								
All Stocks	120	5	5	2	8	-	-0.2357	0.1882

A few points are pertinent here, overall negative observations (8) out number positives (2) after the event. On the event day 2, it is positive. This reflects a downward tendency of AAR on and after the event. The same scenario continues across the two stratification. Under stratification by size of capital, it is 18 negatives as against 12 positives and under stratification by percentage of dividend we note 25 negatives as compared to 15 positives. This statement gets a bit weaker when the scenarios before the event to perused.

## CONCLUSION:

The study has investigated the impact of dividend on stock prices and after studying the problem thoroughly, it may be concluded that a clear cut pattern in dividend is not observed around the event date. This phenomenon cannot be clearly expressed as the dividend announcement influence the behavior of investors. The results confirm that the dividend announcement has not significant impact on abnormal returns. The results how ever do not indicate that the stock prices always move only upward or downward movement after dividend announcement, it moves both the directions. This study also concludes that more companies shows negative returns around event day in different stratifications. Further research can be done stratifying the stocks based on positive and negative abnormal returns on event day and positive and negative cumulative absolute abnormal returns; this may help to understand selection of companies important to find the impact of dividend on stock prices.

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