ABSTRACT

The relationship between share prices and dividend announcements has attracted a great deal of interest among academics. Therefore, it would be interesting for everyone who interested in share trading to identify the investor behavior of the CSE towards the market events. Dividend announcements are associated with past and present financial performance of firms. Dividend payments provide cash flow to the shareholders but it reduces firm's resources for investment. There is an evidence of capital market that the managers used dividend announcements as a signaling device and shareholders responded to this signal accordingly. Hence this study investigates how the stock price reacts to the dividend announcements of the all industrial and commercial companies quoted on the Colombo Stock Exchange, distributing their dividends over the period 2010-2014. Sample of the study consist of 348 dividend announcements after validating the data set of 1168 dividend announcements. For deeper understanding of the study, sample was categorized into three categories: positive, negative and neutral according to the Aharony and Swary (1980) the naïve 'no change' expectations model. There are 144 positive dividend announcements, 89 negative announcements, 115 neutral dividend announcements. Event study methodology developed by Asquith and Mullins (1983) used to analyze the average abnormal returns and cumulative abnormal returns around the dividend announcement day within 41 event window period. Expected return on share *i* on day *t* can be calculated using two well accepted models Market-Adjusted model and Raw returns model. Results gain from the study shows that market reacts positively to positive dividend announcements and negative reaction on negative announcements with the significant reaction on the announcement day while market does not react significantly on neutral category on the announcement day. In summary, there are positive market reaction from investors to both positive and negative dividend announcements and negative market reaction for the neutral dividend announcements. The results of the all three sample support the informational content hypothesis but the magnitude is change. Therefore Sri Lankan results are difference from developed market results.