

Share Price Reactions to the Announcement of Rights Issues on the Colombo Stock Market

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This study examines the rights issues announcement and thereby provides a test of the semi-strong form of market efficiency on Colombo Stock Market in Sri Lanka using the event study methodology with Mean Adjusted Abnormal Return Model (MAARM).

A number of empirical studies show contradictory results. This study addresses two major empirical questions: (a) How does the Sri Lankan share market respond to rights issues announcement in terms of the number of trading days, liquidity of stocks, the size of the rights issues, the sectors, and the year? (b) What form of market efficiency is there in Sri Lankan share market?

These issues are investigated through an overall sample of 50 rights issue announcements relating to 44 companies in 14 sectors for the period from January 1994 to December 2003. For the analysis the researcher considered an estimation period of 75 days and test period of 51 days.

The study concludes that, first, overall sample at portfolio level reveals that rights issues have statistically positive reaction on share price around the days very close to the announcement day. And thereafter, results show mixed of positive and negative reactions. However, the evidence of this study is not consistent with the semi-strong form of market efficiency. Second, market reacts dramatically to announcements of rights issues for illiquid stocks and that exhibit significant positive reaction compared to the liquid and moderate level liquid stocks. And all three samples results do not confirm the semi-strong form of market efficiency. Third, share price reactions vary according to the size of the rights issue. The market reacts positively to the announcement of rights issue when the larger the size of rights issues. And it is inconsistency with the proposition that larger the size of rights issues has larger the significant positive reaction. Fourth, the share price reactions vary according to the sector. Bank, finance and insurance sector results confirm the semi-strong form of efficiency while other sectors do not confirm it. Finally, the results of the share price reactions vary according to the year. Generally, the result of all the years confirms the result of the overall sample relating to semi-strong form of efficiency. But years 1998 and 2003 only confirms the nature and significance of the share price reaction.

Key Words: Rights issue; Liquid stocks; Illiquid stocks; Mean adjusted abnormal return; Event Study

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