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**IMPACT OF DIVIDEND
STABILITY ON STOCK PRICES
IN THE CONTEXT OF SRI
LANKAN LISTED COMPANIES**

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Abstract

This paper examines whether there is any significant relationship between a stable dividend policy and firm's performance in the context of Colombo Stock Exchange which is an emerging market. More recent empirical studies have looked at the association of dividend stability with risk factor. Stable dividend signals the stability of the underlying cash flow as this translates into lower level of uncertainty and business risk, while variable dividend stream will increase fluctuation of cash flows in the hands of shareholders. Thus they will require a higher rate of return in order to compensate them for the uncertainty of cash flows that they have to endure. Though the stable dividend hypothesis testing has been done in the context of number of developed markets less attention has been given to emerging stock markets.

This dissertation examines the relationship between the dividend stability and the stock prices of publicly quoted companies in Sri Lanka which is an emerging market. The study used firm-level data sets of forty publicly traded companies on the Colombo Stock Exchange between 2003 and 2007. The study developed a research hypothesis, which was used to represent the main theories of dividend stability and stock prices. In the study a model was set up to evaluate the inter-relationship between independent and dependent variables and the model used to test the stability of dividend policy was Dumentier (1984) model.

Overall the study results suggest that there is no significant impact of dividend stability on stock prices. The study also revealed that there is a significant relationship between dividend and stock prices. Also there is a significant relationship between capital gains and share prices. The underlying learning is that corporate Managers may not over emphasize on maintaining stable dividend payments as investor preference to same is not implied through the share prices.

