

# Nepalese Stock Market Reaction To Dividend Announcement: An Event-Study Analysis

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**Abstract**—The study evaluates the response of the Nepalese stock market to dividend declarations. Taking the representative sample of 49 listed firms (22.37% total listed companies in Nepal Stock Exchange), i.e., the large-cap companies from each sector, an Event study methodology using the Capital Asset Pricing Model (CAPM) is employed to calculate the Cumulative Abnormal Returns (C.A.R.) using different event windows around the dividend declaration date and we also check the information asymmetry, if any. We document that the Nepalese stock market reacts negatively to dividend news. In the Nepalese Market, in contrast to common conjecture, we find that for high market capitalized firms, there is no dividend information leakage before the announcement at the aggregate level; however, high C.A.R. & high stock price volatility in the pre-dividend declaration window, signal information leakage prevails in some sectors and some companies. Based on our samples, the results indicate that the Nepalese stock market is inefficient. The results of this study will help investors to make their investment decision wisely, and regulators can use the findings of this research to make prudent regulations for the overall development of the stock market.

**Index Terms**—Stock price, Dividend information, Market efficiency, Event study, Information Asymmetry

**JEL Classification:** G11, G12, G14, G35

## I. INTRODUCTION

The Capital market is one of the most significant participants in the financial system channelizing funds from shortage units to surplus units. Developing a well-functioning capital market can ignite economic growth and innovation (Narayanawamy et al. 2017). As revealed by Filip et al. (2012), investors in the capital market are sensitive to both financial and non-financial information, and dividend declaration is one of the

major events impacting the stock price of announcing firms. The investors react to that information based on whether the capital market is in weak form or semi-strong form, or strong form efficiency<sup>1</sup> and how significant the information content is. As per the Dividend Signaling Theory too, the announcement, like an increase in dividends, gives a positive signal to the stock market as it indicates the growth prospect of the company, and investors will go for that stock due to 'Fear of Missing Out ' or Prospect Theory hypothesis. Similarly, the decrease in dividend rate or information of non-payment pushes stock prices downward (Benesh et al., 1984). As such, this paper aims to investigate the impact of dividend declaration on the stock prices of 49 companies (with 17,893 observations) listed on the Nepal Stock Exchange in the Fiscal Year 2021/2022 and test a semi-strong form of market efficiency.

## II. THE RATIONALE OF THE STUDY

The stock market is crucial for economies like Nepal, where raising capital from other sources is not as easy, and economic growth and stock market development have been positively associated (Bist, 2017).

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<sup>1</sup> Weak form efficiency means current market prices of the securities reflect all the past information; in Semi-strong form, all the publicly available data is adjusted, whereas Strong form efficiency includes both public and insider information. The idea of an efficient market was first pronounced by Fama (1970).

Though the relationship between events and stock market movement has been widely studied in developed and developing countries, not much study has been done in the case of Nepal. In Nepalese context, Dangol (2016) discusses the effect of

dividend and earning announcements on stock prices, but our paper focuses only on aggregate response to dividend announcements without dividing that into positive news or negative ones. Further, we include the top capitalized companies in our sample from each listed sector in the Nepal Stock Exchange and provide fresh post-COVID-19 pandemic evidence. As such, this paper fills the gap in this area in the Nepalese context and will also induce researchers to explore more in the domain.

The remaining sections of the paper are arranged as follows. The related literature discussed is in section 2. Research Methods are described in section 3, followed by the Data Analysis and Discussions in section 4, and section 5 concludes.

### III. LITERATURE REVIEW

Several empirical event studies have been made on the impact of dividend announcements on the stock market, revealing both positive and negative influences. The Irrelevance Theory of Dividend argues that dividends do not affect the stock price or firm value. In contrast, the Relevance Theory advocates that dividend matters, both schools of thought are discussed here.

One of the very first studies done to analyze the relationship between Dividend Policy and stock value was by Miller & Modigliani (1961) and argued that under a perfect capital market<sup>2</sup>, the dividend doesn't impact the value of the firm and is supported by other scholars like Black and Scholes (1974), Miller and Scholes (1978), Chen et al. (2002), Phillips and Sipahioglu (2004), Uddin and Chowdhury (2005), AlAli et al. (2019) and Budagaga (2020) amongst many others.

<sup>2</sup> The no transaction cost, tax, or information asymmetry situation is considered a perfect capital market.

Similarly, Ali & Chowdhury (2010) also did not find evidence of dividend announcements affecting the stock price in the Dhaka Stock Exchange, Bangladesh, and Seyedimany (2019), using an event study with the Market Adjusted Model, analyzed the impact of special dividend announcements on stock prices of 5 companies listed on the NASDAQ stock exchange from 2014-2018. The results show no

effect as hypothesized by Dividend Signaling Theory and support Miller and Modigliani.

Contrary to Miller and Modigliani (1961), Walter (1956), Foster & Vickrey (1978), Arif & Finn (1986), and Stevens & Jose (1992) documented a significant association between dividend announcement and stock value. DeAngelo and DeAngelo (2006) also discuss the irrelevance of Miller and Modigliani's proposition; the same has been found in the U.K.'s market, too (Hussainey et al., 2011).

Denis et al. (1994) arrived at results that explain the positive association between dividend change announcements and stock price reactions. From Greece, Vazakidis & Athianos (2010) provide evidence of abnormal returns on different event windows. Similar results were obtained by Majanga (2015) in Malawi. Similarly, Ngoc & Cuong (2016) depict that dividend declaration positively influences the stock market around announcement dates and remains up to ex-dividend dates. Studying the stock prices of NIFTY 50 stocks listed on the National Stock Exchange, India, Singh & Tandon (2019) found a significant impact of dividend policy on the stock price. In the case of Pakistan, Tanveer & Jamil (2019) show a meaningful relationship between dividend announcements and stock price. They also reveal evidence of insider trading as high positive returns were obtained just before the announcement dates. The study by Hariyanto & Murhadi (2021) in ASEAN countries provides empirical evidence of positive abnormal return when the dividend is increased and the opposite in the case of a decrease.

### IV. RESEARCH METHODS

#### A. Data

The study assesses the relationship between dividend announcements and stock price movement, the daily secondary data of 49 companies (49 dividend announcements) listed on the Nepal Stock Exchange (NEPSE), with 17,893 observations. The stock price & market return data were collected from the website of the Nepal Stock Exchange, while the 91-Days Treasury Bill rate data was collected from the website of Nepal Rastra Bank. As per the Annual Report of the Securities Board of Nepal (SEBON), as of FY 2020/21, there are 219 companies listed in

NEPSE, making our sample 22.37% of the total listed companies. Top market cap companies from 11<sup>3</sup> sectors are chosen based on selection criteria as below.

- I. Dividend declared, or dividend information formally provided during Fiscal Year 2021/22 i.e. July 16, 2021, to July 16, 2022.
- II. The company's share has traded for at least 150 trading days before the dividend declaration date and a minimum of 15 days post-declaration.
- III. The announcement date should be free from other confounding events.

If the dividend-related announcement is made on a non-trading day, the next trading date is considered day 0. Data analysis was done using Stata Software.

*B. Event Study Methodology*

Event studies<sup>4</sup> assess a particular event's impact on the securities' returns, and several scholars have been using Event studies frequently to test the efficient market hypothesis (Kritzman, 1994). In 1933, James Dolly analyzed the effects of stock splits on securities values, the first published work on event studies (Mckinlay, 1997). After that, many studies have been done, and event study methodology has evolved into different formats. The empirical literature reveals that event studies can be done using Market Adjusted Model, Market Model, Constant Mean Return Model, and risk-adjusted models like Capital Assets Pricing

<sup>3</sup>NEPSE has categorized companies into 12 sectors. Companies from the 'Hotel' sector were not taken as they could not meet the selection criteria.

<sup>4</sup>For more details about event studies, please see Kothari and Warner (1997), Kritzman (1994), and Mackinlay (1997).

Model, Fama French Model & Arbitrage Pricing Theory (APT) Model. In our study, we use the CAPM model to examine the effect of dividend announcements on stock prices following Kothari and Warner (1997).

For the study, for the assessment of normal returns, the estimation window of 150 days to 30 days before the event date is considered. Based on those standard returns, abnormal returns in different event windows

were calculated using Capital Assets Pricing Model with the following model.

$$CAPM AR_{it} = R_{it} - \alpha_i - \beta_i(R_{mt} - R_{ft}) \quad (i)$$

Where i= Particular stock among n firms in the sample

t= Day relative to dividend announcement day i.e. t=0

AR<sub>it</sub>= Abnormal Return for stock 'i' on day 't'

α<sub>i</sub> and β<sub>i</sub> are the intercept and slope estimated from the pre-event estimation window.

R<sub>mt</sub> - R<sub>f</sub> = Market Risk Premium, R<sub>f</sub> is 91-days T-Bills Rate used as Risk-Free Rate

R<sub>it</sub> = Daily return<sup>5</sup> of stock 'i' on day & R<sub>mt</sub>= Daily market return<sup>6</sup> of NEPSE

V. DATA ANALYSIS AND DISCUSSION

The reaction of individual companies in the sample and overall response also is assessed while significance is tested using a t-test and robustness. The same has been done industry-wise too.

*A. Daily Mean CAR over -3 to +3 days*

Figure 1 shows the daily Cumulative Returns from -3 to +3 days using Capital Assets Pricing Model (CAPM). The CAR does not follow any specific paths but shows high CAR in 2 days before the event and starts decreasing one day before the event showing little improvement with positive CAR before declining to fall into negative zone & declining day by day but drifting from day 4 onwards.

<sup>5</sup>Daily stock Return R<sub>it</sub> is calculated as (Price<sub>i,t</sub> - Price<sub>i,t-1</sub>) / Price<sub>i,t-1</sub>

<sup>6</sup>Daily Market Return R<sub>mt</sub> is calculated as (Index<sub>t</sub> - Index<sub>t-1</sub>) / Index<sub>t-1</sub>

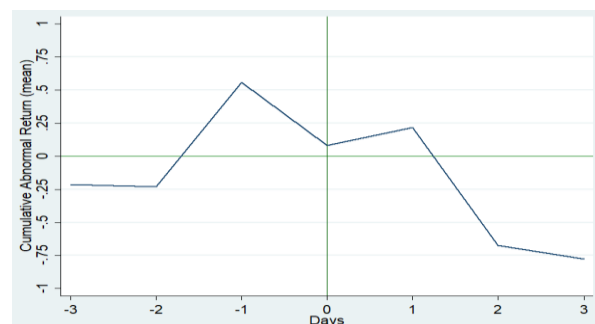


Figure 1: Daily Mean CAR over -3 to +3 days  
Source: Stata Results

**B. Test of market Reaction in different event windows**

The results (Table 1) show that the dividend announcement generates negative returns on 31 days, 21 days, and 15 days event windows, and the 21 days event window shows the highest CAR of -5.12%. The impact is also statistically significant, meaning the market reacts negatively to the dividend announcement, and such announcements contain price-sensitive information. The result of an adverse CAR reaction is consistent with the findings of Hn(2019) in the Indian experience, Ndung'u et al. (2014) in Kenya, and the study of Easton and Sinclair (1989). In London Stock Exchange, Karim (2010) also find out that a positive dividend declaration leads to an adverse market reaction and no reaction in New York Stock Exchange.

Table 1: Cumulative Abnormal Returns (CAR) in different event windows

Event Window	Coverage	CAR (mean)	t-statistics	p-value <sup>7</sup>
31 days	-15 to +15 days	-4.751	-2.50**	0.016
21 days	-10 to +10 days	-5.127	-3.25***	0.002
15 days	-7 to +7 days	-2.907	-2.02***	0.049

\*\*\* Significance at 1%, \*\* at 5%, \* at 10%

Source: Stata Results

<sup>7</sup>The significance is also verified using robust standard errors.

**C. Test of Information Asymmetry**

Table 2: CAR in different event windows

Coverage	CAR	t-statistics	p-value
-15 to -1 day	.701	0.41	0.686
-7 to -1 day	.411	0.45	0.652
-1 day	.573	1.63	0.109

\*\*\* Significance at 1%, \*\* at 5%, \* at 10%

Source: Stata Results

The tables 2 depict the CAR and test statistics in different pre-event windows attempting to analyze the information leakage regarding dividend rates even before announcing to public.

The result shows the pre-event window generates positive abnormal returns consistent with Kang & Diltz (2000), which indicated that information had already passed onto the market, causing information asymmetry among insiders and outsiders, though, on an aggregate level, the result is not statistically significant. Our results of high CAR and stock price volatility before the dividend declaration support the results of Obaidullah (1992) also, who found that the share prices fluctuated and reflected even before the announcement of dividends and revealed that investors could achieve high abnormal returns using the 'buy and bonus' strategy. The result contradicts Foster & Vickrey (1978), who did not find positive returns on ex-dates.

The return volatility and fluctuation range in the 15-days to the 1-day window before the dividend announcement, as shown in Table 3, differs in different sectors. Higher volatility may also suggest that insider information is being passed to a particular group of investors or insiders themselves trading in the stock market. The results show Hydropower sector, as commonly assumed in the Nepalese stock market, is prone to information leakage as investors investing in certain hydropower companies earned as high as 56.63% just in a window of 15 days before the declaration of dividends. The Life-Insurance, Finance, and Development Bank sectors follow the Hydropower sector in the information asymmetry among investors.

Table 3: Sectoral CAR in -15 days to -1 days pre-event period

Sector	CAR (Mean)	CAR (Max)	CAR (Min)	Volatility
Hydro	12.134	56.631	-11.55	21.312
Life Insurance	1.692	11.202	-17.76	10.527
Finance	-6.653	3.678	-24.67	9.677
Development Banks	-7.085	2.391	-18.19	7.138
Non-Life Insurance	7.772	19.724	1.24	6.692

Commercial Banks	-4.413	4.528	-11.71	5.834
Others	0.352	5.904	-5.2	5.555
Investment	0.642	4.597	-3.62	3.038
Microfinance (Laghubitta)	-0.103	3.478	-5.35	2.979
Manufacturing & Processing	0.409	1.618	-1.24	1.183

Source: Stata Results

D. Reaction after the announcement of dividends

The results (Table 4) depict that the market reacts negatively to the dividend declaration and holds up to 45 days too. The negative cumulative abnormal return increases with an increase in the event period. The t-statistics and P-value show that the dividend announcement significantly impacts stock prices. The result supports the evidence provided by Mallikarjunappa & Manjunatha (2009), revealing that positive abnormal returns can be obtained after dividend announcement in the Indian context. Our results also may suggest the inefficiency Nepalese stock market, so learning lags of investors are there, and the prolonged event period is also significant.

Table 4: Post-announcement reaction of the market

Coverage	CAR	t-statistics	p-value
+1 to +15 day	-5.543	-3.96***	0.000
+1 to +30 day	-7.771	-4.07***	0.000
+1 to +45 day	-8.854	-3.40***	0.001

\*\*\* Significance at 1%, \*\* at 5%, \* at 10%

Source: Stata Results

D. Stock returns volatility

Table 5 depicts the stock price volatility, proxied by the standard deviation of stock prices, showing that the stock market volatility is decreasing in shorter event windows. The results show that investors take time to react in the market, which may be due to information asymmetry and learning lags.

Table 5: Volatility of Cumulative Abnormal returns around event dates

Event Window	Coverage	Volatility of CAR
31 days	-15 to +15 days	13.188
21 days	-10 to +10 day	10.945

15 days	-7 to +7 day	10.003
7 days	-3 to +3 day	6.566
3 days	-1 to +1 day	5.819
1 day	Event day	2.759

Source: Stata Results

VII. CONCLUSION AND IMPLICATION

The study finds the relationship between stock price and dividend declaration, which shows that investors act as per the information flow regarding the corporate payout policies. The result is consistent with Karim (2010) for England, Vazakidis and Athianos (2010) for Greece, Mamun et al. (2013) for Bangladesh, and Abbas (2015) for Syria. Many scholars have obtained similar results in many other developed and emerging markets.

The result of the adverse reaction of the stock market is in line with the results of Easton and Sinclair (1989), Karim (2010), Ndung'u et al. (2014), and Hn(2019). The company having surplus funds but not paying dividends may signal that the company may be eyeing an attractive investment opportunity that may make investors better off (Black, 1976), so the declaration of dividends may have had a negative impact on the stock prices of those companies. Contrary to the common perception in the Nepalese Stock Market, we could not find evidence of information leakage before declaration dates, especially in the case of high market-capitalized companies, consistent with results in Turkey Kadioglu & Ocal (2015). Still, in some sectors and companies, the high return fluctuation and high C.A.R. indicated the passage of dividend information beforehand.

The result of this research would support firms in shaping their dividend payout policies and announcement times to maximize the shareholders' wealth. Similarly, policymakers, who are more concerned about the smooth functioning of the stock market and protecting general investors, can make prudential regulations to curb insider trading and purposeful announcements to influence the stock market for pumping and dumping, cornering, etc. Investors can reallocate their portfolios according to their risk appetite and return expectation and not fall into the bandwagon trap. Further, this paper can pave a path for Nepalese researchers to explore more about

the event studies using other events like Merger & Acquisition, Right Issues, Follow-on Public Offerings, etc. using more samples and multiple years.

APPENDIX

Company's Name	Sector
Everest Bank Ltd.	Commercial Banks
Global IME Bank Ltd	Commercial Banks
N.A.B.I.L. Bank Ltd.	Commercial Banks
Nepal Bank Ltd.	Commercial Banks
N.I.C. Asia Bank Ltd.	Commercial Banks
N.M.B. Bank Ltd.	Commercial Banks
Prime Commercial Bank	Commercial Banks
Garima Bikas Bank Ltd.	Development Banks
Jyoti Bikash Bank Ltd	Development Banks
KamanaSewaBikas Bank	Development Banks
Mahalaxmi Bikas Bank	Development Banks
MuktinathBikas Bank	Development Banks
Goodwill Finance Ltd.	Finance
I.C.F.C. Finance Ld.	Finance
Manjushree Finance Ltd.	Finance
Pokhara Finance Ltd.	Finance
Reliance Finance Ltd.	Finance
API Power Company Ltd.	Hydro
Arun Kabeli Power Ltd.	Hydro
Butwal Power Company Ltd.	Hydro
Chilime Hydropower Co Ltd	Hydro
Ngadi Group Power Ltd.	Hydro
Sanima Mai Hydropower Ltd.	Hydro
National Hydropower Co. Ltd.	Hydro
Citizens Investment Trust	Investment
Hydroelectricity Investment & Development Co Ltd	Investment
Nepal Infrastructure Development Bank Ltd.	Investment
NRN Infrastructure & Development Ltd.	Investment
Chhimek Laghubitta Bittiya Sanstha Ltd.	Laghubitta (Microfinance)
FORWARD Microfinance Laghubitta Bittiya Sanstha Ltd.	Laghubitta (Microfinance)
Deprosc Laghubitta Bittiya Sanstha Ltd.	Laghubitta (Microfinance)

NirdhanUtthan Laghubitta Bittiya Sanstha Ltd.	Laghubitta (Microfinance)
Sana Kisan Bikas Laghubitta Bittiya Sanstha Ltd	Laghubitta (Microfinance)
Himalayan Distillery Ltd.	Manufacturing & Processing
Shivam Cement Ltd.	Manufacturing & Processing
Unilever Nepal Ltd.	Manufacturing & Processing
Nepal Re-Insurance Co. Ltd.	Others
Nepal Doorsanchar Co. Ltd	Others
Salt Trading Corporation Ltd.	Trading
Prime Life Insurance Co. Ltd.	Life Insurance
Asian Life Insurance Co. Ltd.	Life Insurance
Nepal Life Insurance Co. Ltd.	Life Insurance
Life Insurance Corporation Nepal Ltd.	Life Insurance
National Life Insurance Co Ltd.	Life Insurance
Shikhar Insurance Co. Ltd.	Non-Life
Neco Insurance Company Ltd.	Non-Life
Nepal Insurance Company Ltd.	Non-Life
N.L.G. Insurance Company Ltd.	Non-Life
Lumbini General Insurance Co Ltd.	Non-Life

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