Signaling effect of shifts in dividend policy: Evidence from Indian Capital Markets

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Abstract

Empirical evidence suggests that a large number of studies support the signaling impact of dividends, but the results are more pronounced in developed markets as compared to emerging markets, where because of the weak form of market efficiency, signaling impact is not well established. This study tests this hypothesis in Indian capital markets, in terms of signaling impact due to shifts in dividend policy. The study has defined the shift in dividend policy as increase or decrease of dividend by 20\% from the previous dividend payout rate. Standard event study methodology was applied on 129 such events in the selected time period and these events were further classified according to market capitalization. Whereas large-cap stocks displayed the presence of significant abnormal returns in the pre-event period, the mid-cap stocks displayed the same in the post-event period. The results of the small-cap stocks mirrored that of large-cap stocks but they are the only ones in which cumulative average abnormal returns were found to be significantly displaying the lagged response towards the event. The decrease in dividend rate by 20\% or more did not result in average abnormal returns in either pre-event or post-event window.

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