

MARKET REACTIONS TO CHANGES IN DIVIDENDS AND ANALYSTS' FORECASTS

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Studies exploring equity price movements around dividend announcement days indicate that equity prices react to announcements of unexpected changes in dividends. A positive (negative) equity price response is associated with unexpected increases (decreases) in dividends. The implication is that unexpected dividend increases represent positive information about the firm's prospects and thus should be associated with an increase in share prices. The most promising hypothesis forwarded as an explanation for the above phenomenon is the information content of dividends hypothesis, otherwise known as the signaling hypothesis.

Based upon the signaling hypothesis, this study employs an expanded set of explanatory variables to explain the announcement period return in the vicinity of dividend announcements. There are five different categories of explanatory variables – firm financing, information leakage, firm-specific characteristics, calendar time effect, and dividend-related managerial explanations.

This study provides several empirical findings which expand our knowledge about the determinants that systematically influence the announcement period return. First, contrary to Mann's (1987) findings that revision in Value Line's earnings forecasts prior to the dividend announcement has a large impact on excess returns, our results agree with the information content hypothesis; unexpected dividend change does have an impact on announcement period return. Second, when managers provide a rational explanation for a dividend decrease, the explanation is effectively ignored by investors, and the dividend decrease is directly interpreted as an indication of poor earnings.