THE EFFECT OF STOCK SPLIT TO EFFICIENT MARKET HYPOTHESIS IN NAIROBI SECURITY MARKET FROM 2004-2009

(A SURVEY OF SELECTED COMPANIES QUOTED IN THE SECURITY MARKET)

By

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D53/NYI/PT/23423/2011

THIS RESEARCH PROPOSAL WAS SUBMITTED IN FULFILMENT OF THE REQUIREMENTS OF MASTER DEGREE IN BUSINESS ADMINISTRATION FINANCE OPTION AT KENYATTA UNIVERSITY MAY 2013
DECLARATION

I hereby declare that this research is my original work and that it has not been submitted at any other university or college for any academic work.

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ABSTRACT

Efficient market hypothesis can be defined as a market in which security prices adjust rapidly to the arrival of new information and, therefore the current prices of securities reflect all information about the security. "In an efficient market, competition among the many intelligent participants leads to a situation where, at any point in time, actual prices of individual securities already reflect the effects of information based both on events that have already occurred and on events which, as of now, the market expects to take place in the future." Stock splits Anomalies are empirical results that seem to be inconsistent with maintained theories of asset-pricing behavior. They indicate either market inefficiency (profit opportunities) or inadequacies in the underlying asset-pricing model. The objectives of this study was: To examine the effect of stock splits at the NSE and whether the investor can make abnormal return; To determine the effect of stock splits on Liquidity at NSE and; To establish the effect of stock splits on Company ownership. This research used the event study methodology originally introduced to a broad audience of accounting and financial economists in two landmark papers, event studies have since become ubiquitous in capital markets research. The secondary data was obtained from NSE secretariat informational database and the listed company’s financial statements. The data was analysed using Microsoft excel, Statistical Package for Social Sciences (SPSS) program. A simple methodology based on the market model was both well-specified and relatively powerful under a wide variety of conditions, therefore, the market model was used to compute the abnormal returns. Results indicated that generally, there was an increase in the volumes of shares traded when stock splits were announced. This was especially so in the days around the stock splits. Trading activity was also seen to generally increase after the stock split as compared to that before the split. The results indicate that there is a positive cumulative abnormal return during the entire event window of stock split and after completion stock split. There is need for further study in this area and a need to include more independent variables such as those relating to firm size and dividend expectations so as to determine whether when other factors are considered the market would still react positively to stock split announcements. The study looked at theories relating to why companies split their stock. The reasons why companies split their stock were to achieve an optimal trading range, to achieve an optimal tick size and to signal managements’ confidence in the future stock price.