ABSTRACT

The ex-dividend day price drop less than the dividend amount is an anomaly documented in financial studies. To account for the ex-dividend behavior, eight hypotheses are found: tax-penalty hypothesis, tax-induced dividend clientele hypothesis, short-term trader hypothesis, dividend capture hypothesis, price discreteness hypothesis, open limit order hypothesis, imbalance order flow hypothesis and the risk premium hypothesis. The contribution of this study is to (i) identify which hypotheses are more suitable to explain the phenomenon in the Hong Kong stock market; and (ii) whether there is any profit opportunity remained after accounting for these hypotheses by investigating the stock behavior around ex-dividend day for 1980-2000.

The study compares the drop-off ratios, the proportional price change to dividend amount, excess returns and abnormal volumes in an 11-day testing window around the ex-dividend days by sub-periods analysis (pre-electronic settlement from 1980-1992 and post-electronic settlement from 1993-2000) and category analysis (stocks classified into top, middle and bottom third stocks by yield, risk, liquidity and trading volume level) using regression models and cross-tabulations of key statistics.

When directly adding the round-trip transaction costs based on observed cum-day and ex-day closing prices into the drop-off ratio, the drop becomes even higher than one, which indicates that the short-term trader hypothesis can explain the less-than-one drop-off ratios. The price discreteness and risk premium hypotheses are also found to have some explanatory powers. Though short-term trading activities are implied in the abnormal volume findings, dividend capture practices are shown inactive because greater drop-off ratios (or more negative excess returns) lie with low yield stocks. The firm-specific risk becomes the only

significant factor against ex-day excess return after 1993. This reflects non-diversification short-term activities. However, the yield is less of concern for investors in 1990s. Moreover, intra-day price variations on the ex-day are found to be much higher than the dividend amount, which indicates that there is big potential to take risk for abnormal returns by utilizing the price fluctuations. The study concludes that the positive excess return comes more from price variation affected by arbitrage potential instead of dividend after 1993.