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A review of market efficiency at the Colombo Stock Exchange

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“In an efficient market, the current price of the asset fully reflects all the available information in its current price”. The argument was that in an efficient market, investors cannot reap abnormal profits without taking abnormal risk. Thus, with the dynamic nature of the capital markets, informational efficiency has become a crucial factor for local and foreign investors. The objective of this study is to assess the market efficiency of the Colombo Stock Exchange (CSE). Since the end of civil war that prevailed in Sri Lanka for 30 years, the performance of CSE picked up with the market moving up sharply in the subsequent four years. During that period, many studies have been conducted to test the weak form and semi strong form efficiency at CSE. Subsequently, the market declined due to allegations of market manipulation, exchange rate fluctuations, political instability and the behavior of the world economy among others and has yet to fully recover despite the change of government in 2015. Many empirical work have been conducted to find out the form of efficiency. Researchers have used methods such as *unit root test (ADF model and PP model)*, *descriptive statistic*, *serial correlation and variance ratio test* to find out whether the CSE follow a *random walk pattern*. Local studies have found that CSE does not follow *weak form efficiency*, which was in line with the conclusion, that stock markets in developing countries are not even *weak form efficient*. Studies concluded the same in the immediate post war era. On the contrary, study conducted using bonus issue announcements found it to be *semi strong form efficient*. One of the more recent studies showed that it could not reject that the CSE was *weak form efficient*. Based on this critical review and the mixed results observed, a fresh assessment of the efficiency of the CSE will be undertaken to test *weak form efficiency* using the *ADF model* and *moving average method* to confirm the results of previous studies and perform event study around announcement of dealings by directors to test the *semi strong form efficiency*.

Keywords: Colombo stock exchange, director dealings, efficient market hypothesis, random walk