

Abstract

The study examines various effects associated with CNX NIFTY index revisions, viz., change in price and trading volume, liquidity & the cost of equity capital and firm performance during the period 1998 to 2011 in the Indian context. The study of index revisions revolves around some well-established hypotheses, such as the *Downward Sloping Demand Curve Hypothesis (DSDC)*, *Price Pressure Hypothesis (PPH)*, *Liquidity Cost Hypothesis (LCH)*, and *Information Content Hypothesis (ICH)*. These hypotheses are yet to be tested in the Indian context barring few studies covering DSDC and PPH.

To examine the price and volume effects, event study methodology has been used. The reported results indicate that, there were no permanent price and volume effects for inclusions and exclusions to and from the CNX NIFTY index, hence refuting the DSDC hypothesis. Moreover, the prices and volumes reversed within five days of the effective date for inclusions, while for exclusions, the reversal happened within seven days of the effective date indicating the validity of PPH.

The study has considered various liquidity measures, such as *trading volume*, *turnover ratio*, and *illiquidity ratio* to examine the effect of CNX NIFTY index revisions on stock liquidity. The CAPM model has been used to study the impact of revisions on the cost of equity capital. The results report a decrease in stock liquidity and increase in the cost of equity capital for inclusion firms while, the exclusion firms experienced an increase in stock liquidity and reduction in the cost of equity capital compared to their matching peers. The LCH does not hold true for inclusions and exclusions to and from the CNX NIFTY index.

Further, to examine the effect of CNX NIFTY index revisions on the firm performance, the study has used EPS and other performance measures such as EPS, ROA, ROE, P/E and Tobin's Q. This study reports that, there is a decline in firm performance of inclusion firms while, the exclusion firms show an increase in firm performance compared to their matching peers. There was no information content found among the CNX NIFTY index revisions, hence refuting the ICH. Finally, to study the firm-specific effects in association with the above-mentioned hypotheses, a case study has been undertaken by considering one company each from inclusions and exclusions, i.e. the Hero Motocorp Ltd. and the ABB India Ltd.

Keywords: Index revisions, price and volume, liquidity, cost of equity capital, firm performance.