Abstract

Small firm effect was brought in to the notice of investment community in 1981 by Rolf Banz and Mark R Reinganum, through two different lines of independent studies conducted on the existence of market anomalies, which contradict with the efficient market hypothesis forwarded by Eugine Fama in 1970.

There are a large number of research studies conducted in this area, using stock market information collected from developed stock markets like New York Stock Exchange and American Stock Exchange. However, studies conducted on the smaller developing share markets like Colombo Stock Exchange are very rare. Hence conducting a similar study using share market information collected from CSE will be of prime importance for Sri Lanka investors who are keen in using market anomalies to improve their profitability of equity investments.

This study attempts to examine the relationship between the firm size and average return of Sri Lankan capital market. However, there is no firm relationship between these two variables over the sample period. In the Sri Lankan capital market context beta coefficient, price/earning ratio, liquidity ratio, book to market value, return on equity, dividends per share and debt/equity ratio are important to determine average return of investing in the firms. Therefore the study provides better guidelines for investors and portfolio managers to make optimal investment decisions.