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Announcement Effects on Stock Returns

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EDITORIAL BOARD EXCERPT Initially at the Time of Submission (ToS) submitted paper had a 17% plagiarism which is an accepted percentage for publication. The editorial board is of an observation that paper had been rectified and amended by the authors (Madhulika & Parul) based on the reviewer's remarks and revisions at various stages. The comments related to this manuscript are noticeable related to **Announcement Effects on Stock Returns** both subject-wise and research-wise. The study elaborates the concept of announcement of corporate events and their probable impact on stock return.The authors have crafted the paper in a structured manner. Overall the paper promises to provide a strong base for future studies. All the comments had been shared at different dates by the authors' in due course of time and same had been integrated by the authors in calculation. By and large all the editorial and reviewer's comments had been incorporated in paper and the manuscript had been earmarked and decided under "**View Point**" as the study provides an insight over changing efficiency forms in markets in which can be tested with suitable statistical approaches.The results are interesting and remarkable.

ABSTRACT **Purpose:** The present work elaborates the concept of announcement of corporate events and their impact on stock returns. The magnitude of changeover in returns may vary from the relevance of any information which goes public. The expectations of investors play a vital role and if some event arises in the market whether it is company specific or change in any macro variable, there may be spill over effects. The study has discussed various such type of events and their probable impact on returns.

Design/Methodology/Approach: The previous literature related to events studied like bonus issue, stock split, merger and acquisitions etc have been reviewed and their excerpts have been used to infer the overall findings from different perspectives.

Findings: The major objective of all the studies undertaken in the area of events was to find out the presence/absence of random walk in the stock prices. Event study methodology has been majorly used by all authors for studying the impact of various events. Using CAPM, Market model, GARCH, OLS to name a few significant changes have been observed in abnormal returns.

Proposed Implications: The study provides an insight over changing efficiency forms in markets in India as well as abroad which can be tested with suitable statistical approaches.

Originality/Value: The events have been studied from various outlooks by many researchers. However, the area still has scope for further finding out the changing paradigm of stock price behaviour vis a vis events.

KEYWORDS Event Study | Event | Abnormal Return | Stock price

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Introduction

Stock market is the mirror of a country's economy. It reflects each and every event which takes place inside a particular industry or any individual company. There may be different type of events which may affect the growth and performance of stocks listed at the popular stock exchanges. The announcement of information like mergers/ acquisitions, bonus issue, rights issue, management change, stock split, earnings, dividend etc. can produce a spontaneous reaction in stock prices.

Literature Review

There can be so many events/news which may have an influence on the abnormal stock returns for the industries in India. The effect may be more or less due to some particular events. There can be events which affect the stock returns drastically and there may be certain events which may not affect stock returns at all. Events which are majorly studied by international and national researchers so far are mergers, acquisitions, stock splits, bonus issues, tax effects, political news, management change, earnings announcement, dividend announcement etc.

Mohanty (1999) examined the impact of bonus and dividend policies for 200 Indian companies over a period of 15 years. *Dhar and Chhaochharia (2006)* have incorporated 90 stock splits and 82 bonus issues in their study from 2001 to 2007 of the stocks listed at BSE to understand the effect of such announcements in the market with the help of daily stock prices. *Fama et al. (1969)* revealed that stock splits are usually preceded by a period during which stock return rates are unusually high on the specific securities under split.*Grinblatt et al. (1984)* has inspected the effect of stock split and dividend announcement on the returns of stocks listed at Wall Street from 1967 to 1976.*Agrawal et al. (1992)* attempted to analyze the performance of post-merger of firms listed at NYSE and AMEX from 1955 to 1987.*Tuso et al. (2010)* investigated the usefulness of event studies to measure the effect of merger on the performance of stocks.*Shiller (1980)* has worked on finding out the difference between the stock price predicted as present value of future events and the real prices for the same time period.*Miller and Scholes (1982)* have used capital asset pricing model to find out after tax return effects due to dividend yield.*Denis et al (1994)* have integrated the effect of dividend yield, cash flow signaling and overinvestment for stock price reactions by using a sample of 6777 dividend changes for the period 1962-1988.*Bessler and Nohel (2000)* have assessed contagion effects in bank sector returns for money center banks and non-money center banks.

Examination of Announcements

Event study methodology has been the most common approach in performing research which relates to study of events and their possible impact on stock returns. The events have been studied in various windows to examine their effect in different situations. A variety of financial models are available to perform research on events. The most common in use by the pioneers in financial research are market model, GARCH model, FAMA-French model, Sharpe model, Capital Asset Pricing Model, constant mean return model etc.

Points of Discussion

Bonus issue is generally taken up by a company to adjust its free reserves and surplus profits appearing in the Balance Sheet Theoretically, it is a process of capitalization of reserves and affects the capital structure of the company causing a negative impact on the leverage. This is generally adopted by companies when they are planning a big capital budgeting decision which the market accepts as a positive signal to improve the bottom line of the income statement. The other possibility is the company is unable to tap the bond market because of negative market sentiments. The third possibility is large cash and cash equivalents in the Balance Sheet which the company is unwilling to shed. The last but not the least possibility is that the company does not want to lose the cash component of its assets and wants to maintain its liquidity ratio.

All the above mentioned possibilities are expected to result in a negative change in share prices/ the stock returns because investors may consider it as a signal of low earning per share in the near future due to increased and increase in the number of shares being traded in the market This will also normally increase the volatility of the stock. The share becomes risky for the investor with higher standard deviation. The clientele for the stock may undergo major changes involving closer scrutiny by regulators. Hence any bonus issue happens after careful thought by the Finance manager of the company. Not to mention the increased controlling power in the hands of existing shareholders, which may be a negative factor at the next annual general meeting? But, the effect in context to the literary studies has been found positive. Investors take bonus issue as"good news" because they receive additional number of shares without paying any extra price. Thus, it may result for more demand of shares in the market giving boost to the share prices. As a result, the stock returns may go abnormal for that particular time period. The stock analysts also spend lot of time predicting bonus issues of companies and investors buy shares of companies with impending bonus issues.

Stock split is an action by corporate in which the shares are converted into multiple holdings. This may be regarded as a significant event which may give a positive feeling to shareholders psychologically thereby stimulating the stock prices. It only generates more number of shares keeping the market capitalization of the company constant. Thus, theoretically there should be no change in the market price of the stock being the state of the existing investor remaining the same. But, there is a possibility of change in pre-split and post-split market price due to change in the face value of stock and investor expectations. The split may bring a positive change on stock prices on account of renewed interest of investors in the company. The possible reason for a company to go for stock split may be the increased market price which they want to alter for enabling new investors to come forward. Moreover, many of the companies go for stock split in order to regenerate the interest of old or existing investors.

On the contrary, stock prices will fall in books but its value remains constant. The company may take such an action to make the shares more affordable for small investors thus allowing its investor base to expand.

There may be a temporary effect on the stock price (increase) followed by a fall immediately after the split. It may be due to small investors demand for the stock which boosts up with the stock split. It may provide a signal to the stock market that this phenomenon shall continue in the future.

The marketability and liquidity created in the stock market due to stock split gives a favourable picture for the company. There are studies in this field which examined pre-split prices to be more positive as compared to post split prices. Also, from the angle of investor analysts it has been found that they behave positively towards a stock split as it may raise their commission in the market. The study strongly believed that investors rely on analyst's advice and when prices behave as per the prediction the investors are bound to believe more and act according to them. The number of stock splits has been quite less reducing the interest of Indian researchers.

Merger and acquisitions can be defined as restructuring of an organization for better growth and positing in the market. It may be called as a strategy where similar or different entities join together to produce synergy effect. There is a very minute difference between the terms "merger" and "acquisition" though they are used inter changeably. A merger is a union of two firms into one entity whereas acquisition refers to one company taking over the other where the former becomes the newly formed entity. The combined effect of mergers and acquisitions may stimulate many positive changes for the stakeholders. There has been a lot of research carried over on this issue that whether merger and acquisition as an event has an effect on abnormal stock returns or not.

The literary work done in this field provides opposite results than the expectations from merger news in the market. The studies suggest negative abnormal returns in case of common stock exchange offer and normal returns in case of cash offer. Most of the studies have used event study methodology to understand the joint effect. It has also been found that a long run event window may explain the merger effect in a better manner as compared to short run window.

Dividend is that part of a company's profit which is distributed among its shareholders. The earnings announcement by no means indicates a positive picture of any company's fundamentals. The existing investors shall consider it as a bright signal assuming company has got ample profits. On the other hand, it may also be taken as dearth of opportunities in the hands of managers which may be a probable reason to declare dividends. However, the former justification seems stronger in Indian stock markets.

The dividend announcement may be said as a "welcome" decision by the Indian investors. They may consider it from the view point of "Bird in the Hand Argument" i.e. sooner the dividend is received better it is. This strongly holds true for the investors who prefer liquidity and regular returns.

Thus, dividend announcement may affect the stock prices positively or negatively depending upon investor expectations at a particular period of time. In most of the cases, researchers have so far found significant and positive impact on the abnormal stock returns in Indian as well as international stock markets.

Dividend announcement has been very closely observed by Indian and international researchers so far. Most of them have used event study methodology as a base in their respective studies. The two variables have been picked in general in all studies; dividend (quantitatively/qualitatively) and stock prices. Cumulative abnormal returns have been calculated with the help of various models like Sharpe, Constant Mean Return Model, Market Model, Fama French, CAPM etc. The model choice though depends on the type of market and country under observation. Statistical tests like t-test, z-test, regression, correlation, sign test etc. have been commonly used.

Management Policy: The entry or exit of any management personnel especially any key resource person like Chief Executive Officer or Managing Director may produce noise at the stock market. This may be due to investor perception attached to it and thus stock prices may react whenever there is a change in management of a given company. For instance, the comeback of Narayana Murthy to Infosys brought laurels to its stock prices. In addition to it, stock prices may also show increase/decrease due to policy changes introduced by the management from time to time. They may even act in response to a particular behaviour by a manager professional like holding or leaking important information about the company fundamentals. The listings depicted here definitely call for a research in this field. However, there are rare studies related to management policy changes and the information about company's management actions may not be traceable that easily. It may involve challenges which are beyond the control of a researcher. The studies which have been done in this regard talk about findings based on common sense. There are no ways to detect the next management action so that the investor may act accordingly and plan his investment strategy.

Conclusion

It has been statistically proven inmany studies that the news which went public in the stock market produced reactions in the stock prices. The studies depict maximum usage of event study methodology to find the impact of a particular event on stock returns. Market model and CAPM have been used in many studies to compute expected returns thereby calculating abnormal returns. As regards to bonus issue, empirical results show positive response of investors being abnormal returns turning higher after bonus issue. Stock split announcement produced opposite reactions as compared to bonus issue. The returns turned lower in the post-split period of studies indicating a negative response by investors. Merger and acquisition is another important event which has been found to produce opposite results than expected by the market. The results from different studies indicated negative returns in case of common stock exchange offer and normal returns in case of cash offer. This means that merger effect could not produce any extraordinary returns for investors.

Apart from the above events, studies have been carried in regard to management policy changes. The major challenge for this event had been lack of insider information to researchers. It is infeasible for an individual to find policy changes to understand stock price changes due to them. The studies which have been done in this regard are more of common sense than empirical research. Efficient market hypothesis continues to be the base of study in all event studies with which various events have been studied. The purpose of all these studies was to understand existence/absence of random walk in stock prices.

Dividend announcement which is one of the most important declarations for any investor who has plugged his funds in the stock market is the base of the present study. Dividends produce noise in the stock market and investors take it as “welcome” news. Researchers have so far found positive and significant reactions from stock prices due to dividend declaration. The scholars have shown with event study methodology in most of the studies that dividend has affected stock prices both before and after the news was provided.

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The Editorial Board had used the ithenticate plagiarism [http://www.ithenticate.com] tool to check the originality and further affixed the similarity index which is 17% in this case (See Annexure-I). Thus the reviewers and editors are of view to find it suitable to publish in this Volume-10, Issue-3, July-Sep, 2018

Annexure 1

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