MARKET REACTIONS TO CORPORATE ANNOUNCEMENTS: A CONCEPTUAL ANALYSIS

Dr. Chandrashekhar R., *Asst. Professor, Department of Business Administration, Mangalore University*

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Abstract: *Investors cannot consistently achieve abnormal returns in an efficient market. Current market price of a stock reflects all publicly available information if the market is semi-strong efficient. In a semi-strong-form efficient market, it is implied that share prices adjust to publicly available new information very quickly and that no abnormal returns can be earned by trading on that information by the inventors. According to the semi strong form of the efficient market hypothesis the current market price of a firm's share accurately reflects the available public information about the firm and the new price relevant information that has been made public.This paper examine the results of market reactions to corporate announcements presented in different studies across different markets. Prior research reveals that the market anticipates the information contents in the corporate announcements and incorporates this information in the current market price before the announcements.*

Key Words: *Market Efficiency, Corporate Announcement, Abnormal return.*

1. Introduction

The efficient-market hypothesis (EMH) states that financial markets are informationally efficient. If the markets are efficient, one cannot consistently achieve returns in excess of average market returns. If the market is semi-strong efficient, the publicly available information should be reflected in the firms' current stock prices. In semi-strong-form efficiency, it is implied that share prices adjust to publicly available new information very quickly and that no excess returns can be earned by trading on that information by the inventors.According to the semi strong form of the efficient market hypothesis the current market price of a firm's share accurately reflects the available public information about the firm and the new price relevant information that has been made public [Ogden, et. al. (2003)]. Malkiel (1989) records that a stock market is said to be efficient if it accurately reflects all relevant information in determining security prices. He opines that the reports of the death of the efficient market hypothesis appear premature. Further he observes that in an efficient market information contained in past prices is included in current market prices, and any publicly available fundamental information is rapidly assimilated into market prices. He also records that if some degree of mispricing exists, it does not persist for long and it is usually only recognizable after it occurs. "True value will always out" in the stock market.

2. Objective of the Study

The objective of the study is to examine the market reactions to corporate announcements and the status of efficient market hypothesis presented in the literature.

3. Market Reactions to Corporate Announcements

The efficient markets theory of financial economics states that the price of shares reflects all relevant information that is available about the companies at any point of time.Vaidyanathan and Kanti (1994) tested the weak form of market efficiency using run test, serial correlation test and filter rule test. Their results provide supportive evidence for the weak form of the efficient market hypothesis.Isagawa (2002) examine the stock price behaviour to the announcement of corporate open market repurchase strategy. He reveals that absence of lon-run stock price increases after open market repurchases announcements. Dhatt (2010) examine the impact of buyback announcement on share prices in Indian market. He reveals that the announcement of buyback has a positive impact on the share prices and its effect is fully incorporated in the share prices by the announcement day. Ray (2010) tested the semi strong form of efficiency in Indian capital market for bonus issue and right issues announcement. He finds that Indian stock market is efficient in semi strong form with respect to bonus issue announcement. Ghatak (2011) examine the stock price reaction to information release of bonus issues or stock splits with a view of examining whether the Indian stock market is semi-strong efficient or not. His findings confirm that Indian Capital Market is semi-strong in nature for Efficient Market Hypothesis point of view.Pinches and Singleton (1978) argue that the informational content of bond rating changes is very small and the stock markets are efficient in processing this type of information for both bond rating increase and decrease. Peterson (1987) examines daily price reactions to initial reviews of securities by the Value Line Investment Survey. He found significant abnormal returns over a 3-day period around release of the information. Further he reveals that there is no statistically significant subsequent price reaction after this 3-day period, which is consistent with market efficiency.Trahan and Paul (1995) examine the impact on stock prices of purchase recommendations published in the popular financial weekly, Barron's. Their results show that the publication of this second-hand information has a positive and significant impact on stock prices at the time of publication. They also find that the abnormal returns quickly disperse and the recommendations examined here do not provide superior returns over longer holding periods.Singh and Power (1992) observe that rating changes are found to convey no information to the capital market. They also argue that the absence of stock price reactions in response to rating changes are a non-event in terms of new information conveyed to the market. Matolcsy and Lianto (1995) provide evidence on the information content of bond revisions by controlling for the information content of concurrent annual accounting income numbers and testing the incremental information content of bond rating revision. They indicate that only the announcement of bond downgrades has incremental information content.

The market effect of stock splits on stock price, return, volatility, and trading volume around the split ex-dates is analysed by Reboredo (2003) in the Spanish stock market and confirms a negative effect on price and return of stock and the presence of a positive effect on volatility and trading volume. His results suggest that stock splits have induced the market to revise its optimistic valuation about future firm performance, rejecting signalling hypothesis according to which splits convey positive information to markets.Rao and Ramachandra (2004) evaluate the response of stock prices and volumes to bond rating changes in Indian capital market. They found that stock price incorporates the factors that lead to rating revisions. They also report that upgrades are received cautiously by the investors with no significant abnormal returns where as downgrades are perceived as bad news by investors with significant negative abnormal returns.Yi and Donald (2006) show that initial loan ratings and upgrades are not informative, but downgrades are. They also find that the market anticipates downgrades to some extent. Chandrashekar and Mallikarjunappa (2008) reveals that the announcement bond rating have not provided any additional information to the market and returns associated with the announcement of bond ratings are insignificant. They state that Indian capital market is efficient in semi strong form in processing the new information.Davidson et al (1994) examine a sample of 535 announcements of corporate crime and obtain an overall insignificant stock market reaction. Chandrashekhar (2016) proves that the announcement of demerger is not a new news to the market. The market is efficient in absorbing any news quickly and reflects in the current market price of the share. Chandrashekhar and Mallikarjunappa (2013) study the impact of bond rating on the stock returns of the Indian companies. Contrary to the evidence of prior studies they reveal statistically insignificant abnormal stock return associated with the bond down grades. Their results are consistent with the findings of earlier studies on bond upgrades. They opine that the bond upgrades and downgrades do not convey any important information to the market in Indian market. Chandrashekhar (2014) examine the stock price responses to the publications of Brokers' Call the free stock recommendations published in The Business Line in newspaper over three year period. He reveals that the publications of Brokers'Call do not contain any information content. Further he opines that Brokers Call does not help the investor to make any abnormal return and Indian Capital Market is efficient in the semi strong form.

Some researchers disproved the efficient market hypothesis and provided evidence that the market is slow in processing information. Glascock et al. (1987) show that equity returns react significantly around bond rerating. They show that the market is somewhat slow in assimilating the rerating information. Pilotte (1992) indicates that the stock price response to new financing is significantly, positively related to a variety of growth opportunity measures.Akhigbe and Madura (1999) reveal that the industry responds positively and significantly to bank stock repurchases. Ikenberry et.al (2000) found that the market on average seems to under estimate the information contained in repurchase announcements. Their finding is consistent with well documented findings in the United States, that long run abnormal stock returns for these cases are negative.Choy et al. (2006) find that only downgrades contain price relevant information and their evidence is consistent with the result of US market. Further they find that the market reacts significantly for an unregulated firm and reduce the firm's rating by more than one category. Poon and Kam (2008) find negative signalling effects in rating downgrade sub-sample.Contrary to the Chinese market they find that credit ratings in China have information content. Behr and Andre (2008) analyse the stock market reaction to the assignment of an initial unsolicited rating and find evidence that this reaction is negative. They opine that unsolicited ratings are based on publicly available information only and the stock market seems to be inefficient in processing this information for Japanese companies.Mishra (2009) examines the efficient market hypothesis by testing the same for Indian capital market and adds to the literature the evidence of its weak form inefficiency. Mishra et al (2010) analyse the key market parameters such as market size, market liquidity, market turnover ratio, market volatility, and market efficiency of Indian capital market. They provide the evidence of greater volatility and weak form inefficiency of the market. Chronopoulos et al (2013) provides evidence for a significant relation between the announcement-period abnormal returns and the post-merger profit efficiency changes.

4. Discussion

Table No. 1: Recorded Market Responses to the Corporate Announcement

Sl. No	Researcher	Corporate Announcement	Result
1	Akhigbe and Madura (1999)	Stock Repurchases	Inefficient
2	Behr and Andre (2008)	Unsolicited Ratings	Inefficient
3	Chandrashekhar (2014)	Brokers' Call	Efficient
4	Chandrashekhar and Mallikarjunappa (2008)	Bond Rating	Efficient
5	Chandrashekhar and Mallikarjunappa. (2013)	Bond Rating	Efficient
6	Chandrashekhar (2016),	Demerger	Efficient
7	Choy et al (2006)	Rating Change	Inefficient
8	Chronopoulos et al (2013)	Post-merger profit efficiency	Inefficient
9	Davidson et al (1994)	Corporate Crime	Efficient
10	Dhatt (2010)	Buyback	Efficient
11	Ghatak (2011)	Stock Splits and Bonus Issues	Efficient

12	Glascock et al (1987) ‘	Bond Rating Changes	Inefficient
13	Ikenberry et al(2000	Stock Repurchases	Inefficient
14	Isagawa. (2002)	Open Market Repurchases	Efficient
15	Malkiel (1989)		Efficient
16	MatolcsyP and Lianto (1995)	Bond Rating Revisions	Efficient
17	Mishra (2009)	-	Inefficient
18	Mishra et al (2010)	-	Inefficient
19	Peterson (1987)	Initial Reviews of Common Stock	Efficient
20	Pilotte (1992)	Variety of growth opportunity	Inefficient
21	Pinches and Singleton (1978)	Bond Rating changes	Efficient
22	Poon and Kam (2008)	Credit rating	Inefficient
23	Rao and Ramachandra (2004)	Bond Rating changes	Efficient
24	Ray (2010)	Bonus issue and right issues	Efficient
25	Reboredo (2003)	Stock Splits	Efficient
26	Singh and Power (1992)	Bond Rating Changes	Efficient
27	Trahan and Paul (1995)	Barron's" Recommendations	Efficient
28	Vaidyanathan and Kanti (1994)	-	Efficient
29	Yi and Donald (2006)	Bank Loan Ratings’	Efficient

Stock price responses to corporate announcements are mixed. Malkiel (1989), Singh and Power (1992), Davidson et al (1994), Vaidyanathan and Kanti (1994 0, Trahan and Paul (1995), Isagawa. (2002), Reboredo (2003), Ray (2010), Ghatak (2011), Chandrashekhar and Mallikarjunappa (2013a), Chandrashekhar (2014), Chandrashekhar (2016) and many other researcher supports that arguments that there is no information content and the market is efficient in processing the information whenever the information arrives. The results of Pilotte (1992), Akhigbe and Madura (1999), Ikenberry et al(2000), Mishra P K (2009),Mishra and Pradhan (2009), Mishra et al (2010), Chronopoulos et al (2013) and others provide evidence that the market is inefficient and the announcements provide price relevant information to the market. The results of the prior studies provide sufficient evidence that market is efficient in processing new information and no investor can book abnormal return using the corporate announcements in most of the cases.

5. Conclusion

No investor can make abnormal return in an efficient market. Researchers across the market examine the efficient market hypothesis for different types of corporate announcement. The results of prior study reveals mixed opinion on efficient market hypothesis. Prior research reveals that the market anticipates the information contents in the corporate announcements and incorporates this information in the current market price before the announcements. Therefore the corporate announcements itself does not seem to have any significant impact on the stock price in most of the cases. Market is not efficient in processing certain information very quickly as revealed by some researchers.

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