Relationship of Earnings Announcement with Stock Prices, Investor Reaction and Bid Ask Spreads: Empirical Investigation of KSE.100 Index (2004 - 2013)

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Abstract

The aim of the study is to investigate the relationship of earnings announcements with share process of Pakistani listed companies in 100 index, investor reaction and bid-ask spreads. The sample is acquired from KSE.100 index including 118 companies with sample period of 10 financial years (2004-2013). The data is acquired from various national databases mentioned in methodology. Moreover, Augmented Dickey Fuller (ADF) and regression tests are used for acquisition of findings after data purification and data outlier's eradication. Hence, study lead significant findings as like historic investigations

Keywords: Earnings announcements, Bid-ask Spread, Investor reaction, Stock Prices, KSE.100 index, Sample period, ADF, Regression

INTRODUCTION

An official publicly announced financial reporting regarding returns to investors or shareholders in a way of dividend is pronounced as earnings announcements. Such earnings announcements leads positive and bullish sentiment towards share prices of the company and later of industry with a systematic approach. Thus, first of all such earning announcements leads variation in market prices of the shares with 0.85% in corporate plethora (Brown and Kenelly, 1972). Later, Litzenberger & McEnally, (1977) observed significant absorption of announcement change in financial and derivatives security market.

It is very clearly identified by historic studies that such favorable sentiments and rise in share prices leads financial activities of corporation towards betterment through market perspective. Therefore, such positive change and awarding returns to investors on their risky investment attracts investor's and resembles investor's trust on financial position of company. Thus, such financial trust forces investor's to react in stock market and builds demining or purchasing trend that is already built by provision of returns announcements (Iqbal, Nasir and Bilal, 2015).

Hence, such favorable earnings announcements towards stock prices through investor reaction reduces bid ask spreads and leads corporation to settled prices of financial securities traded on the bases of market demand and supply (Shah, Butt and Hasan, 2009). "While, bid-ask spread is pronounced as when change in price rises because of variant and cross prices by demander and supplier."

Such theoretical frame work leads to sensed objective of the study that to identify the relationship between announcements of earnings with stock prices of the companies, investor reaction and bid-ask spreads. Moreover, it is also planned to investigate that what kind of volatilities of decisions and tinny adjustments built and breaks the targeted relationship of current study. Moreover, utility theory is used as theoretical base and study will reveal key implications for theorists and practitioners of financial market controllers and investors i-e individual and institutional.

RESEARCH METHODOLOGY

The current study aims to investigate the relationship of earnings announcements with stock prices, investor reaction and bid-ask spread of derivative securities. While, the time series data is used in the study by assuming time series is stationary (Gujrati, 2003). Moreover, convenient sampling technique is used to acquire the data. So to test the relationship of these facets it is hypothesized in a way that,

> *H1: There is significant relationship of earnings announcements with stock prices.*
> *H2: There is significant relationship of earnings announcements with investor's reaction.*
> *H3: There is significant relationship earnings announcements with bid-ask spreads.*

Thus, the quarterly data is arranged from KSE.100 index and 118 companies are selected. Moreover, the sample period is from Jan 2004 to Dec 2013. The data is acquired from multiple databases i-e Karachi stock exchange database www.kse.com.pk, State bank of Pakistan database www.sbp.com.pk and security exchange commission database www.secp.com.pk. Moreover, some international databases are also used for data acquisition such as www.brecorder.com and www.oanda.com.

In instrumentation data normality, data reliability tests, correlation analyses are used and to arrange

time series data in stationary way the stationary test is executed firstly identified by Granger and Newbold, (1974). And from verity of stationary test Augmented Dickey- Fuller (ADF) test is used. Thus, the unit root tests are used for the purpose to study that the data used to experiment is stationary or not.

Augmented Dickey- Fuller (1979) test is obtained by the following equation,

$$EA = \propto + \beta 1\ (SP) + \beta 2\ (IR) + \beta 3\ (BAS) + \acute{\varepsilon}$$

The above model/equation represents earnings announcement as EA, share prices as SP, investor reaction as IR and bid ask spread as BAS. Moreover, $\acute{\varepsilon}$ is denoted as error term. Thus, the measurement scales of all variables are mentioned below,

$$Earnings\ Announcements = \frac{[(Pit-1)+Cit]}{Pit} - 1$$

$$Share\ Prices = n.Log(\Delta\ Volatality)$$

$$Investor\ Reaction = n.Log\left(\frac{Pn}{Po}\right)$$

$$Bid\ Ask\ Spread = \left[\frac{Ask\ Price - Bid\ Price}{AskPrice}\right] * 100$$

RESULTS & ANALYSIS

Table 01
Regression Analyses

Variables	Beta	t. Stats	Probability
C	0.347	3.43	0.29543
EA	0.7399	0.4545	0.000
SP	0.4455	0.1375	0.000
IR	0.7389	0.4798	0.001
BAS	0.7632	0.4452	0.003
Adjusted R. Square	0.001659	S.D Dependent Variation	0.06565
R- Square	0.05971	Mean Dependent Variation	0.07145

Significance level at p-value <0.05*

The data is acquired through KSE-100 index and is clarified from outliers and then data is normalized. While the normality of all variables lies from +02 to -02 ranges that is acceptable statistically. Moreover, alpha reliability value of earnings announcements (EA) is 0.892, Share prices (SP) is 0.723, Investor reaction has 0.8327 and Bid-Ask spread has 0.7101 respectively.

Thus, Table 01 shows results of above mentioned econometric model as it is tested. Whereas, earnings management is found significant with share prices, investor reaction and bid-ask spreads with the p value less than 0.05 respectively. Thus, study found significant results earnings announcements are significantly correlated with share prices, investor reaction and bid-ask spreads. Moreover, r-square value is 59.71% that shows the factorial representation of study model. And Mean dependent variation is 0.6565 and standard dependent variation is 0.07145.

CONCLUSION

The study aimed to investigate the relationship between earnings announcements, share prices, investor reaction and bid-ask spreads of funds in Pakistani context. The data is acquired through various databases. On the bases of study model it is concluded that study found significant relationship among earnings announcements, share prices, bid-ask spread and investor reaction as shown in the regression table 01. Hence, study concluded its findings with in the stream of historic investigations. For furthered research it could be analyzed that to what extent there is role of corporate governance to manage and improve performance of these facets. Another future research could be conducted in a way that to what extent these variables affect economic position of corporation.

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