EFFECTS OF EARNINGS ANNOUNCEMENT ON SHARE PRICE: THE CASE OF GHANA STOCK EXCHANGE

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Abstract

The study examines the effects of corporate earnings announcement on the Ghana Stock Exchange (GSE). A sample of 19 listed companies was selected from which 57 observations of earnings announcements documented from 2009 to 2012 were collected for the study. The naïve expectation model was applied to determine the investor’s expectation towards earnings announcements. A 15 trading days inclusive of the day of announcement of earnings was defined as the event window which includes 7 days before and 7 days after earning announcement. The market portfolio index was used in terms of its movements as a substitute for the expected returns which was compared to the actual returns generated from the changes in stock prices for the duration of the event window to determine the existence of abnormal returns. An observation was made which is that there is well built evidence which suggests that earnings announcements do carry weight when it comes to investors making decision on share prices. This shows a very clear position that the investors on the Ghana Stock Exchange rely on the signals that come out as a result of announcements made on earnings in making investment decisions. The findings of this study conform to previous findings of Aharony and Swary (1980); and the recent findings of Dasilas et al (2008).

Keywords: Effects, Share Price, Earnings announcements, GSE

1.0 INTRODUCTION

In Corporate Finance, publicly floated firms are required to disclose to their stakeholders in general and shareholders in particular about their earnings. In practical however, a large number of firms frequently declare to their shareholders in one way or the other, about the progress of earnings. The earnings announcement decision has become one of the crucial policies. Gunasekarage et al (2006) review of empirical literature in their study observed a main theoretical argument proposed to justify the market response to such announcements. First, in the world of asymmetry information between management and investors, where managers have access to detailed operational information of companies, investors cannot always trust managers to provide unbiased information about their company’s future prospects. Therefore, an alteration in dividend policy can be seen as the only reliable source of managerial assessment of future profitability/cash flows of the company. On the other hand, management may disabuse the minds of investors about their financing policy and process in their earnings status. Investors generally are perceived to be value maximizing personalities. Therefore, positive earnings announcements should be associated with good and positive expectation while a negative earnings announcement is expected to generate bad and negative expectation. If the information content theory conjecture is factual, then a neutral earnings announcement is expected to have no influence on perceived value maximizing investors’ positive and negative expectation. The abnormal return to be generated during the earnings
announcement period can be attributed to the 
investor reaction upon hearing the news 

Majority of available empirical work on the 
information content of earnings announcement 
has been done on the developed capital 
märkts in Europe, Asia, and the USA, with 
very minimal number of studies done on small 
and emerging capital markets particularly from 
Africa except a few work on the Johannesburg 
Stock Exchange (JSE). This has undoubtedly 
created a gap. The Ghanaian capital market 
(GSE) since its inception in 1992 has not had 
enough studies done on it. A recent related 
study however, on the capital market was done 
by Amidu and Abor (2006); Amidu (2007). 
These studies did not consider the effects of 
earning announcement on share price that 
warranted this study. The main objective of 
this study is to find the empirical reaction of 
investors to earning announcement on the 
Ghana Stock Exchange.

1.1 Hypothesis

Consistent with extant literature the study 
begins by measuring the investors’ reaction to 
information like earnings announcement; it 
would be determined by comparing the current 
year’s earnings of firm \( i \) in time \( t \) to the 
preceding year’s earnings of firm \( i \) in time 
\( t - 1 \). The expectation of investors (market) 
would be considered favorable when \( E_{it} > E_{i,t-1} \); 
unfavorable if \( E_{it} < E_{i,t-1} \). The above hypotheses is 
expected to agree with the signaling theory 
which assume that good or bad news such as 
earning increase or decrease announcements 
should convey information to the market about 
the firm’s future prospect.

- A favorable expectation \( E_{it} > E_{i,t-1} \) must 
be associated with an increase in 
earnings announcement and as a 
result leads to a positive effect on 
shareholders wealth.
- An unfavorable expectation \( E_{it} < E_{i,t} \) 
should be associated with a reduction in 
earnings announcement and as a 
result leads to a negative effect on 
shareholders wealth.

2.0 THEORETICAL LITERATURE

The conveyance of vital information on 
earnings announcements about the future 
expectations of companies has become an issue 
of great importance since it affects the prices 
of shares of firms listed on the stock exchange. 
This then implies that in order for investors to 
take decisions on where to direct their funds 
and as a result leads to a positive or 
favorable earnings that give them the utmost 
assurance of prospective higher returns. Upon 
the release of company’s earnings, various 
analysts try to relate them to their previous 
estimates or previous performance of 
companies to ascertain how good or bad 
performances have been over the period 
which will lead them in making decisions on 
which project will be viable or worthwhile.

Surprise earnings announcement be it 
positive or negative greatly have influence on 
the share price. For instance, a positive 
surprise earnings announcement can push 
higher (up) the stock price on the stock market 
which the reverse is true. Surprise earnings 
information arises when stock analyst ascertain 
an either upward or downward trend compared 
to their estimates based on previous 
performances of various companies. 
Performance evaluation of firms by investors 
in the capital market is very important such that 
it provides them with a unit of information 
source in the public arena. Earnings 
announcements contain data only if it is able to 
change the ideas, perceptions and beliefs of 
market participants relating to the valuation of 
assets and other financial performances.

It is also important to state that there will be 
the likelihood of information (earnings 
announcements) differences due to the fact that 
various groups of investors have different 
forms of acquisition abilities and even the level 
of resources availability to acquire that same 
information. Market participants who have a 
little expertise in acquiring information and 
lack the resources normally depend on public 
information which tends to be general to all 
whilst the highly skilled and hugely resourced 
investors operate basically on pre-disclosure 
symptoms of information in making decisions 
on various investment portfolios. This 
indicates that there would obviously be clear 
difference between these two groups of 
investors. There will be investors who are 
differently informed prior to expected earnings 
announcements which will result in them 
having different views (response) to the 
Ball (1978) for instance attests to the fact that for over 20 years now there has been the issue of incompleteness of share price reactions towards earnings announcements in the finance and accounting writings. This is as a result of lapses in the way or method of devising research tools to address the issue of risk and transaction costs. Bernard and Thomas (1989; 1990); Freeman and Tse (1989); Mendenhall (1991); and Wiggins (1991), argue that there is the likelihood of the post earning- announcement drift attributable to the failure on the part of stock prices to impact fully on the implication of current earnings for expected potential earnings. As indicated earlier, abnormal or excessive returns possibly and potentially arise as a result of gaining information or knowledge on earnings. The level of abnormal returns could be determined by the period of earnings on the announcement day or period in question. It could either drastically reduce the worth of the stock price (negatively) or increase it (positively).

Empirical evidences shown by Patell and Wolfson (1984) documented that huge or immense abnormal returns occurred mostly when stock market analysts obtained immediate knowledge within thirty (30) minutes of the announcement with basically a substantial part of the returns taking place within the first 5 to 10 minutes.

The preliminary response of stock prices to earnings announcement whether it has full or partial reflection could be corrected in the long run. Given a close gap in relation to post earning-announcement, the correction would not be very clear considering the possibility of unsuccessful anticipated future earnings coming into reality. The literature revealed information relating to evidence of partial reflection earnings information but some others as indicated above hold the view of stock prices which over reflect on the knowledge acquired on earnings (over reaction). There has been an indication by DeBondt and Thaler (1985) that companies which do not achieve well and for that matter having a negative abnormal stock price appear to be very effective and efficient (that is to say, they perform well) than those whose stock price become excessively positive. There is actually difference between abnormal returns after earnings announcement and the one before the announcement. The Pre-earnings announcement of abnormal return could be as a result of information leakage (grapevine) into the capital market Ball and Brown (1968). This happens when cumulative abnormal returns (CARs) keep on with an upward drift with regards to firms that were perceived to have improved upon a decrease in their earnings exposure whilst on the other hand, firms that experienced a decrease in their earnings exposure will have a downward drift and for that matter, a cumulative abnormal returns (CARs) as well. DeBondt and Thaler (1985) also added that bad news from firms with prior severe negative presentation of stock market price are of the impression that they do better than those firms with good news which had prior excessive positive presentation of the stock market price.

3.0 METHODOLOGY

The paper used the standard event study methodology. The most important focal point of this study is to analyze the signaling effect of earnings announcements. In measuring the information content of earnings announcement, there should be a basis on which this is done. The analysis period shows the distance end to end of time by which the observations of returns on a daily series is undertaken. This research considered a 15-day event window beginning from -7 day to +7. Extant studies have kept the record of the event date ambiguity which influences or distresses the verve of the tests. This is intended to discover the occurrence of abnormal performance connected to an event Johnson (1998); Wright and Groff (1986).The announcement (event) date as indicated in this research is made clear and observed as the instance of the authorized declaration of earnings issued by the executive board of the companies which constitute the sample for the study.

3.1 The Expectation Model

In order to empirically analyze the effects of earnings announcement on the share price, it is important to examine the expectations of market participants before the announcement of earnings. The expectation model applied in this work is the naïve model. The definition of the expectations of market participants (investors) have met several earlier empirical studies and amongst them have been identified with Ghosh and Woolridge (1991); Fuller (2003). Under the naïve model, there is the presupposition that, present earnings are expected to be equal to the prior earnings which are shown as;
E_{it} = E_{it-1} \text{ Where: } E_{it} \text{ represents the current annual earnings of selected company } i \text{ in time } t.

E_{it-1} \text{ represent previous annual earnings of selected company } i \text{ in time } t - 1.

Apparently, there will be a comparison between the present earnings announcement and the previous earnings announcement. This will help in the determination of the favorability and unfavorability of the investors’ and market participants’ reaction to the earnings information. Earnings announcement is regarded as favorable to investors if E_{it} > E_{it-1} and unfavorable if E_{it} < E_{it-1} as stated in the hypothesis. It is quite clear that investors may have reason to expect a significant change in the future prospects of a firm upon the realization of earnings information publicized in the market and in the daily news papers which indicate a signaling favorable current earnings announcement. The daily market adjusted abnormal return (MAAR) and the daily cumulative abnormal return (CAR) is applied in order to be able to measure the effect of earnings announcements on the share prices in the expectation situations. The MAAR points out the comparative daily rate of change in price of the firm which discloses the earnings information and this is expressed in percentage (%) terms compared to the change in the average market price. Ghana Stock Exchange (GSE) all share index is used as the substitute of the average market price. The Market adjusted abnormal return (MAAR) is calculated as:

MAAR_{it} = R_{it} - R_{mt} \text{} \text{ Eqn 1.}

MAAR_{it} \text{ represents the market adjusted abnormal return for security } i \text{ over time } t. \text{ } R_{it} \text{ represents the time } t \text{ return on security } i, \text{ calculated as:}

P_{it} - P_{i(t-1)} \text{} \text{ Eqn 2.}

P_{it} \text{ represents the market closing price of security } i \text{ on day } t. \text{ } P_{i(t-1)} \text{ represents the market closing price of security } i \text{ on day } t - 1. \text{ } R_{mt} \text{ represents the time } t \text{ return on the GSE-All Share Index calculated as:}

MAAR_{it} = \frac{P_{it} - P_{i(t-1)}}{R_{mt}} \text{} \text{ Eqn 3}

MAAR_{it} \text{ represents the time } t \text{ return on security } i \text{ Relative to the market index. The calculated result of the MAAR indicates the rate of change in percentage terms in the value of security individually resulting from the earnings announcement which is then weighted against the Market Index (average market return). whatever difference that results, signifies the unsystematic fraction of the changing value precisely for each security from the ensuring earnings announcement. The other subsequent model which is the cumulative abnormal returns (CAR) is used to compute the total return of investors over a particular period beginning from the prior announcement of earnings up to after the earnings announcement day. A 15-day window period beginning from -7 day to +7 day is used for the study. The cumulative abnormal return (CAR) is calculated as:}

\text{CAR}_{t} = \sum_{j=-7}^{7} MAAR_{jt} \text{} \text{Eqn 4.}

\text{CAR}_{t} \text{ represents the cumulative abnormal return, MAAR}_{t} \text{ represents the Market adjusted abnormal return, and } J \text{ represents the day -7 through to today +7.}

4.0 EMPIRICAL RESULTS

The Ghana Stock Exchange has specifically classified the companies into industry sectors. For instance, the Financial Services sector comprises all commercial banks, financial and insurance companies. The table below presents the percentage composition of the firms in the various industries that constitute the sample for the study.

<table>
<thead>
<tr>
<th>INDUSTRY CLASSIFICATION</th>
<th>NO. OF FIRMS</th>
<th>% OF FIRMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Services</td>
<td>7</td>
<td>28%</td>
</tr>
<tr>
<td>Petroleum Exploration and Production</td>
<td>1</td>
<td>4%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>6</td>
<td>24%</td>
</tr>
<tr>
<td>Automobile</td>
<td>1</td>
<td>4%</td>
</tr>
<tr>
<td>Technology &amp; Comm.</td>
<td>1</td>
<td>4%</td>
</tr>
</tbody>
</table>

Table 4.1: Industry Classification
The empirical analysis of the market’s reaction to earnings announcement on the Ghana Stock market starts with an examination of the market adjustment abnormal returns. The general trend is found in Table 4.1.1 below. This explains the way the market reacted to each of the firm’s earning announcement. Because earning announcement is usually a deliberate action designed, to disseminate price-sensitive information, this section attempts to examine how the market instantaneously incorporated and adjusted stock prices before, during and after the earnings information. If there is a significant abnormal return especially before the declaration date then it would probably be due to leakage of information from insiders. In this section, the study examined if: a) Trading results were associated with important released information of earning announcement, b) If there is any unusual return associated with trading before earning declaration.

This presents the general outlook of investor’s reaction to earning announcement on the Ghanaian capital market. Generally financial analysts and economists all over the world agree that price movement on any capital market must be responsive to good or bad news. It is rational to expect that investors are concerned about their returns, and hence their reaction to such news. Previous studies suggest that there are several reasons why investors may react differently to earnings announcement based on market conditions. Thaler (1983) argue that investors may treat earning announcement as a silver lining when capital gains return is negative. On the other hand, when capital returns are positive he states that earning announcement may be treated by investors as an added bonus. Previous studies in behavioral finance, such as Shefrin and Statman (1984), propose that investors do not act consistently in all circumstances. They find that money is not a homogenous item, and that its source can determine how the money is spent. If this is true, then it is possible that market conditions can help determine the value that investors place on different components of return emanating from such earning announcements.

Table 4.1.1: General Trend of the Market Adjusted Abnormal Returns (MAAR)

<table>
<thead>
<tr>
<th>DAY</th>
<th>TOTAL(MAAR)</th>
<th>AVERAGE</th>
<th>CAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>-7</td>
<td>-0.00404</td>
<td>-0.00101</td>
<td>-0.00101</td>
</tr>
<tr>
<td>-6</td>
<td>-0.0027</td>
<td>-0.00067</td>
<td>-0.00169</td>
</tr>
<tr>
<td>-5</td>
<td>0.003141</td>
<td>0.000785</td>
<td>-0.0009</td>
</tr>
<tr>
<td>-4</td>
<td>0.003822</td>
<td>0.000955</td>
<td>5.54E-05</td>
</tr>
<tr>
<td>-3</td>
<td>-0.00465</td>
<td>-0.00116</td>
<td>-0.00111</td>
</tr>
<tr>
<td>-2</td>
<td>0.034028</td>
<td>0.008507</td>
<td>0.007401</td>
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<td>-1</td>
<td>-0.0123</td>
<td>-0.00308</td>
<td>0.004325</td>
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<tr>
<td>0</td>
<td>-0.01334</td>
<td>-0.00334</td>
<td>0.00099</td>
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<td>0.027753</td>
<td>0.006938</td>
<td>0.007928</td>
</tr>
<tr>
<td>+2</td>
<td>0.020062</td>
<td>0.005015</td>
<td>0.012943</td>
</tr>
<tr>
<td>+3</td>
<td>0.004384</td>
<td>0.001096</td>
<td>0.01404</td>
</tr>
<tr>
<td>+4</td>
<td>0.004736</td>
<td>0.001184</td>
<td>0.015224</td>
</tr>
<tr>
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<td>0.007207</td>
<td>0.001802</td>
<td>0.017025</td>
</tr>
<tr>
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<td>0.008821</td>
<td>0.002205</td>
<td>0.019231</td>
</tr>
<tr>
<td>+7</td>
<td>0.000457</td>
<td>0.000114</td>
<td>0.019345</td>
</tr>
</tbody>
</table>
The total of 57 earnings announcements was used for the study as shown in table 4.1.1 above. This represents 100% of the selected sample. The day, -7 to day -5 consistently documented negative cumulative abnormal return except for day -5 that the MAAR registered a positive return of 0.31%. It then decreased again to 0.005.5% in day -4, which is very minute. After day -3, the CAR consistently recorded positive to the last day of the event window under consideration. The market adjusted abnormal return (MAAR) observed also appeared to record negative prior to the announcement day except for a few days -5, -4 – 2 that managed to record positive MAAR. After the earning declaration day, both the market adjusted abnormal returns and cumulative abnormal return took a dramatic turn. It documented positive returns up to day +7. This is not surprising given that markets generally are expected to receive such news with investors trying to purchase more shares or off load their shares. In this scenario, it implies that the average investor on the stock exchange on the average received the news of earnings announcement with buy decision.

In addition, as the MAAR is estimated from the actual changes in the prices of the equities less the movements in the portfolio market index use as proxy for the expected return, the MAAR was reasonably influenced by the movements in the market portfolio index. According to the dividend signaling hypothesis, a favorable earnings announcement should signal information to investors which must have a positive change in share prices and hence increase shareholders’ value. That is exactly what occurred from the announcement day onwards. Therefore, investors on the Ghana Stock Exchange reacted promptly positive upon hearing the news of the earnings announcement. Day +1 recorded the highest return of 2.78%, which is in order given that most of the earning announcements on the stock exchange normally arrive late usually at around 4:00pm when the market closes at 4:30pm. It is expected that the effect of the news will be realized in the following day. Therefore, the positive MAAR and CAR from the declaration day to the day +7 did not come as a surprise. It means that investors on the stock exchange attached earnings announcements with value increasing effect.

**Market participants’ reaction to favorable news**

Earning announcements are regularly found in the financial media. The responses to such announcements are that share prices usually increase or decrease following that news. Jin (2000) has acknowledged that price changes do not always follow this typical pattern. But we must note that no matter how little the earning may be there is the likelihood that investors will respond favorably to positive earnings announcement.
Table 4.1.2: Favorable Expectation of Shareholders

<table>
<thead>
<tr>
<th>DAY</th>
<th>TOTAL (MAAR)</th>
<th>AVERAGE</th>
<th>CAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>-7</td>
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<td>-0.00083</td>
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<td>-6</td>
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<td>+7</td>
<td>0.006994</td>
<td>0.000636</td>
<td>0.000503</td>
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</tbody>
</table>

Figure 4.2.1: Graphical Trend of Favorable Expectation of Shareholders

A positive average MAAR of 2.49% is observed on the day when a favorable earnings announcement was declared to shareholders. This however came after the first three days such as -7, -6 and -5 continuously recorded negative returns. Subsequent day -4 documented positive returns followed by negative return again in day -3. But the CAR rather shows an interesting trend. Whereas the market adjusted abnormal return (MAAR) recorded positive and negative day by day, the CAR preceding the announcements date consistently registered negative return. Positive cumulative abnormal returns (CAR) only occurred until the announcement day, day [0]. The consistent negative returns of the cumulative abnormal returns could mean that investors did not have any prior knowledge of such news to the announcement day. That probably could explain that investors did not attach so much importance to trading before the announcement. However, the results of CAR after the declaration of earnings increment, is in line with the signaling theory.
which says that managers will always want to send to the investors that they should expect good future prospects of the firm by using dividend increment announcement.

Market participants’ reaction to unfavorable news

If we use the example of Norton (2008), we can confidently argue that from 2004 to 2006, the Ghanaian stock market was in a bull market that some consider it to be the strongest time that Ghana has ever seen. There were a few market drops along the way such as what has become known as the 2008 world economic meltdown and the currency crises of the late 2009. However, neither of these events caused too much disruption as the stock market increased on an annual basis for each calendar year during this time period. It is possible that entering a bear market from such a prolonged bull market may affect the way the investors react to earnings announcement leading to unfavorable response.

Table 4.1.2: Unfavorable Expectation of Shareholders

<table>
<thead>
<tr>
<th>DAY</th>
<th>TOTAL (MAAR)</th>
<th>AVERAGE</th>
<th>CAR</th>
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</thead>
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<td>5.05E-05</td>
<td>-0.00429</td>
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</tbody>
</table>

Figure 4.2.2: Graphical Trend of Unfavorable Expectation of Shareholders

Table 4.1.2 presents the market reaction to the unfavorable earnings announcements. If investors are to react according to their expectations as the signaling theory suggests, then the results in this table depict the picture of negative wealth effect. Aharony and Swary (1980); Asquith and Mullins (1983) all argue that by earnings announcements, significant information is sent to the equity holder. Once
market actors are expected to act according to their expectations, this led to negative reaction of the investors on the Ghana Stock Exchange as shown in table 4.1.2 above. Except for five days which are day -5, day -4, day +4, day +6 and day +7, the rest of the days trading within the event window reported negative market adjusted abnormal returns.

In addition, the average market adjusted abnormal return almost documented negative returns entirely except for day -4 and day +4. By this result, the days that saw positive average MAARs obviously could not override the negative effect resulting in the CAR being negative throughout the event period. This however is not unusual since according to the dividend signaling proposition, a decrease in dividend should trigger a corresponding reaction from investors which will push down the prices of equity. The declaration day of the earnings announcement documented negative total market adjusted abnormal returns, average market adjusted abnormal returns and cumulative abnormal returns as -0.37%, -0.11% and -0.887 respectively. This result therefore indicates we cannot reject the argument that says the announcement of earnings decrease should go hand in hand with corresponding downward movement of stock price resulting in negative effect to shareholders wealth. It is worth noting that the market only acted based on rational principles of behavioral finance. John and Williams (1985) alluded that investors will attach much importance to credible firms when they announce dividend payment. The argument underpinning this is that investors have the rational behavior to judge and price or attach values to the shares of the firm. That will translate into share price performance on the market.

5.0 CONCLUSION

The main objective of this study was to test the effect of earning announcement on share prices on the Ghana Stock Exchange. It could be labeled information content theory of earnings. A sample of 19 listed companies was selected from which 57 observations of earnings announcements documented from 2009 to 2012 were collected for the study. The traditional event study methodology proposed by Brown and Warner (1985), Otchere (2004) was used to test the data and the findings suggest that earnings announcements contain important information on which investors rely on to make their investment decisions. The study observed that the market reacts to earnings announcements either positively or negatively depending on whether the news is about earnings increase or reduction. It was observed that any time earnings increment announcement hits the market; investors reacted accordingly pushing the stock price upward or downward after the declaration day according to the type of announcement. The findings of this study conforms to the previous findings of Aharony and Swary (1980); Asquith and Mullins (1983) and the recent findings of Dasilas et al (2008), and Ayse and Elif (2010). Their findings all observed a corresponding investors’ reaction to earning announcements. Therefore, it can be concluded that earnings announcements do convey information to the market which investors react accordingly. Though Osei (2002) lamented that the Ghanaian capital market is weakly efficient, it did not contradict our findings given that no matter how slow the investors react to earning announcements, they do so with either positive or negative expectation and that expectation drives the stock price movement.

REFERENCES


