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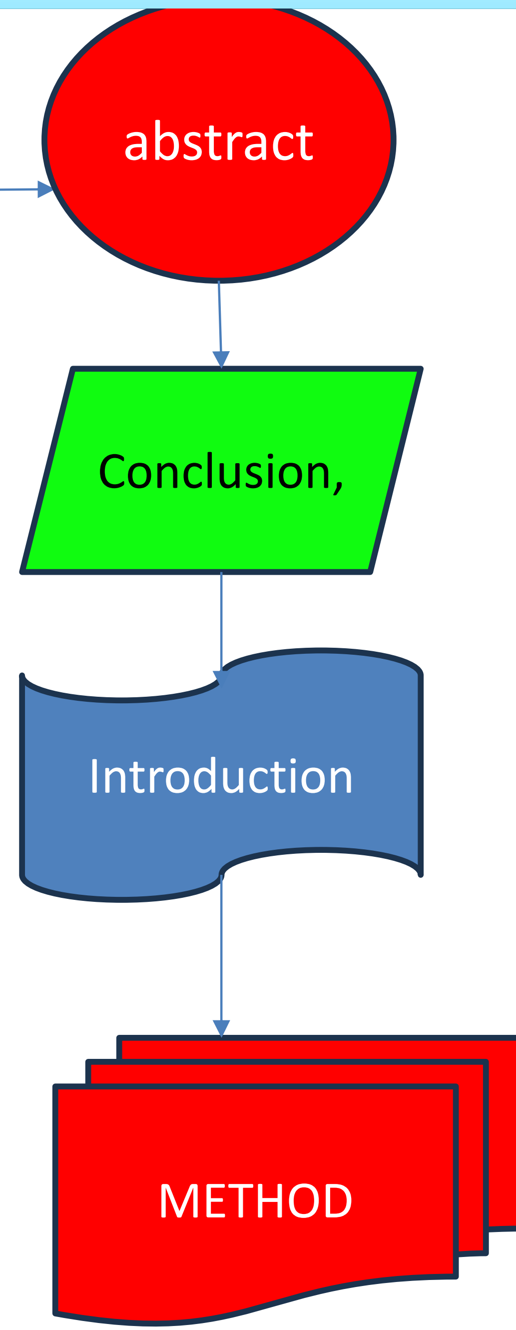

Differential Price and Volume Reactions to Accounting Earnings Announcements

Bamber & Cheon (1995)

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ABSTRACT: Prior research acknowledges that an earnings announcement may generate heavy trading but minimal price changes, and vice versa. Surprisingly, there is little empirical evidence regarding the extent of such occurrences. This study investigates the frequency with which earnings announcements generate differential price and volume reactions, and then assesses whether these differential reactions are associated with announcement-specific characteristics. Although there is a positive relation between the magnitudes of price and volume reactions (on average), nearly a quarter of the announcements generate price and volume reactions of very different relative magnitudes. Additional empirical evidence is consistent with the notion that trading volume is likely to be high relative to price reaction when an earnings announcement generates differential belief revisions among investors, but a small average aggregate market belief revision.

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- Surprisingly, there is little empirical evidence regarding the extent of such occurrences.

Abstract

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- Additional empirical evidence is consistent with the notion that trading volume is likely to be high relative to price reaction when an earnings announcement generates differential belief revisions among investors, but a small average aggregate market belief revision.

Abstract

- The focus on similarities between price and volume reactions has naturally led researchers to view price and volume as substitute measures of "market reaction."
- Significant conceptual differences exist, however, between price and volume reactions to informative disclosures.

Introducton

- Surprisingly, there is little empirical evidence concerning differences between the magnitudes of price and trading volume reactions to accounting disclosures, even though research has acknowledged the possibility of differential price and volume reactions (see, for example, Beaver 1968; Lev and Ohlson 1982; Dontoh and Ronen 1993).

Introducton

- We address this issue by providing evidence on two questions. The first question is:
- How often do earnings announcements generate large price changes but little trading, or vice versa?
- After documenting the existence of differential reactions, we provide initial evidence on the second question: Are these differential reactions related to announcement specific characteristics?.

Introduction

- This study investigates the frequency with which earnings announcements generate differential price and volume reactions, and then assesses whether these differential reactions are associated with announcementspecific characteristics.

Abstract

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- The first question is: How often do earnings announcements generate large price changes but little trading, or vice versa? After documenting the existence of differential reactions, we provide initial evidence on the second question: Are these differential reactions related to announcementspecific characteristics?.

Abstract

- Our empirical investigation is based on a sample of price and volume reactions to 8, 180 quarterly earnings announcements by 1,079 firms, during the period 1986-1989.
- Consistent with prior research, we find that the magnitudes of price and volume reactions are positively related.

introduction

- The study examines market reactions to earnings for fiscal quarters between 1986 and 1988, inclusive, which are announced between 1986 and 1989.10
- The sample observations meet four selection criteria:
  (1) a quarterly earnings announcement date is available from COMPUSTAT (PST or Research file),
  (2) returns, excess returns, and trading volume data are available from (at least) the day before to five days after the earnings announcement, from the *CRSP* NYSE/AMEX files,
  (3) analyst forecast data are available from the *Institutional Brokers Estimate System (JIB/EIS)* tapes, and
  (4) the firm has a December 31 fiscal yearend.11 These criteria yielded a sample of 8, 180 quarterly earnings announcements by 1,079 firms.

Research Design

- Although there is a positive relation between the magnitudes of price and volume reactions (on average), nearly a quarter of the announcements generate price and volume reactions of very different relative magnitudes.
- Additional empirical evidence is consistent with the notion that trading volume is likely to be high relative to price reaction when an earnings announcement generates differential belief revisions among investors, but a small average aggregate market belief revision.

Abstract

- Consistent with prior research, we find that the magnitudes of price and volume reactions are positively related.
- However, our evidence suggests that this relation is weaker than expected.
- Nearly a quarter of the earnings announcements generate either

  (1) very high trading but little price change, or

  (2) large price change but little trading.

Introduction

- Evidence of such substantial differences between price and volume reactions suggests that trading volume-based research has the potential to yield insights beyond those attainable through price-based research.
- Further empirical analysis suggests that earnings announcements that generate high trading volume reaction (relative to price reaction) are associated with (I) divergent financial analysts (predisclosure) earnings forecasts; (2) large analyst followings; (3) large magnitude of random-walkbased unexpected earnings relative to analystbased unexpected earnings; and (4) stock price increases.

Introduction

- The study's empirical results are broadly consistent with the general intuition underlying much theoretical trading volume research:
  - when an announcement generates differential belief revision, trading volume is likely to be high.

Introduction

- These results have implications for researchers and policymakers who consider market reactions as evidence of a disclosure's usefulness to investors.

Introduction

- Our empirical evidences, that accounting announcements often generate either
  - (I) high trading volume but little price movement, or
  - (2) large price changes but little trading, suggests that it is important for policymakers and researchers to consider both price and volume reactions to accounting disclosures in order to avoid drawing unwarranted conclusions.

Introduction

- The primary objective of this study is to provide empirical evidence on the extent to which accounting earnings announcements generate heavy trading but minimal price change, or vice versa.
- Although price and volume reactions to earnings announcements are significantly positively associated, on average, the frequency of earnings announcements that generate trading volume and price reactions of similar magnitudes is only 8,11 percent higher than would be expected under the null hypothesis that trading volume and price reactions are *independent.*

Summary and Concluding Comments

- While there is a significant positive association between volume and price reactions, this positive relation obscures the facts that
  (1) the relative magnitudes of price and volume reactions are extremely different for 20,24 percent of our sample earnings announcements, and
  (2) the observed relation between price and trading volume reactions is closer to independence than to a strong positive relation.

Summary and Concluding Comments

- Our evidence further suggests that earnings announcements that generate a high trading volume reaction relative to price reaction are associated with

  (1) more divergent financial analysts (predisclosure) earnings forecasts;

  (2) a large analyst following;

  (3) higher randomwalkbased unexpected earnings relative to analystsbased unexpected earnings; and

  (4) price increases.

- These results are broadly consistent with the notion that trading volume reaction is likely to be high (relative to price reaction) when an announcement generates differential belief revisions among individual investors.

Summary and Concluding Comments

- We believe the evidence reported here highlights the potential for empirical trading volume based research to yield new insights regarding the effects of information on stock market participants, since we find that trading volume often behaves differently than stock prices.
- Moreover, our evidence suggests that these differential reactions are related to announcement specific characteristics.
- Such empirical evidence on factors associated with differential price volume reactions can potentially help theoreticians develop more complete (and descriptively valid) theories of trading volume.
- From an empirical perspective, the study' s results suggest that it would be prudent for future information content research to continue to examine both price and volume reactions

Summary and Concluding Comments