EFFECT OF INTERIM FINANCIAL STATEMENT ANNOUNCEMENT ON STOCK RETURN AND VOLUME OF SHARE TRADED OF LISTED COMMERCIAL BANKS IN KENYA

BY

LUCY WAMBUI NGURE
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DECLARATION

This Research Project is my original work and has not been presented to any other institution for examination.

Signed……………………………………… Date………………..

LUCY NGURE
D61/76052/2012

The Research Project has been submitted for examination with my approval as the University Supervisor.

Signed……………………………………… Date………………..

MR. JAMES NG’ANG’A
LECTURER, DEPARTMENT OF FINANCE AND ACCOUNTING,
SCHOOL OF BUSINESS,
UNIVERSITY OF NAIROBI
DEDICATION

I dedicate this research project to my husband Jesse Gitaka, who tirelessly encouraged me to pursue the highest level of education in the land. While am still on that route, his encouragement keeps me going. I also dedicate this project report to my children, Mandela Gitaka and Baraka Ngure who give me the impetus to work hard and ensure they have the best in their lives.
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ABSTRACT

Interim reports have become another important instrument that allows companies to communicate with its shareholders in providing timely information. They enable investors to make economic decisions whether to retain, buy or sell their shares. The first chapter involves the background of the study, detailed discussion on the announcement of interim reports and the relationship between interim reports, stock returns and traded volume, research problem, research objectives; to evaluate the effect of interim financial statements announcement on stock return and traded volume. The chapter also explains the significance and justification of the study. The second chapter is the literature review which involves the theories related to interim reports and related studies done on the impact of interim reports on stock return. Chapter three is research methodology. The general purpose of the study was to evaluate the effect of interim financial statement announcement on stock return and traded volume of listed commercial banks in Kenya. The study was carried out through event study methodology focusing on three listed commercial banks. Secondary data obtained from Nairobi Stock Exchange was used to analyze changes in share price and traded volume from 2009 to 2013. Data from a sample of three banks namely: Equity bank, Barclays bank and standard Chartered was used to make conclusions of the whole population. Abnormal returns during an event window of 15 days were determined using a market model and trading activity ratio was calculated. According to this research interim financial announcement were informational events that caused increase in stock return and thus the information made by the companies was useful in valuing securities. Further research findings showed that abnormal returns and cumulative abnormal return around the announcement of interim financial statement were positive. The study concluded that security prices react to interim financial statement announcement and thus the study supported the semi-strong form efficient market hypothesis since stock prices adjust to public information. The recommendation of the study in order to reduce abnormal returns is that CMA should ensure compliance with insider trading laws, guidelines, rules and regulations by effectively monitoring the market.
CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Recently, interim reports have become an important source of information’s that provide users with timely information to make decisions. In 1998 the International Accounting Standards Committee (IASC) issued the International Accounting Standard 34 (IAS 34) “Interim Financial Reporting “which defined interim financial report as a financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period. Interim report might be issued quarterly, half yearly or for any other period depending on the regulations of the country concerned.

Interim reports provide updated information. Timely disclosure of accounting information has its roots in efficient market theory (Scott, 1997). According to this theory, the management of a company is obliged to provide information to investors and other stakeholders to be able to appropriately make economical determinations in allowing them to make better predictions about the company’s future profitability and the firm’s cash flows (Scott 1997). The agency theory as advanced by Jensen and Meckling (1976), models the relationship under which the agent (managers) acts on behalf of the principal (shareholders) by providing credible and reliable information to shareholders through financial reports (Eisenhardt, 1989).

The Nairobi Stock Exchange (NSE) was founded in 1954. During the first three years of independence in 1963, the stock market experienced steady growth, rekindling
confidence in the market. There are various sectors that trade shares at the NSE namely: Agricultural, Banking, and Insurance. Banking industry in Kenya is regulated and governed by the Companies Act (Cap 486), the Banking Act (Cap 488) and the Central Bank of Kenya (CBK) according to bankinginkenya.com. Currently, there are 11 listed banks in Kenya which include: Barclays Bank Ltd, CFC Stanbic Holdings Ltd, I&M Holdings Ltd, Diamond Trust Bank Kenya Ltd, Housing Finance Company Ltd, Kenya Commercial Bank Ltd, National Bank of Kenya Ltd, NIC Bank Ltd, Standard Chartered Bank Ltd, Equity Bank Ltd, and the Co-operative Bank of Kenya Ltd (Nairobi Securities Exchange, 2013). Banking industry in Kenya has grown tremendously over the last five years reporting a combined profit after tax of KES. 28.2 billion as at 31st March 2013 and a deposit base of KES. 1.8 trillion, according to www.bankinginkenya.com.

The Ernst & Young 2014 Global Survey showed that despite the challenges faced by the Kenyan banking consumer, the country was still ranked the most confident market after Nigeria and ahead of South Africa. Consequently this industry has generated keen interest from both international and local investors who rely on interim reports for their decision making (Standard Media).

1.1.1 Announcement of Interim Reports

Interim financial statement is a summary of a company’s financial activities for an accounting period less than one year; it can be semi-annually, quarterly or even monthly, (IAS 34). According to IAS 34, publicly traded entities are encouraged to provide interim financial reports at least as of the end of the first half of their financial year, not later than 60 days after the interim reporting date. Interim reports are supposed to provide less
information as compared with annual financial statements due to the interest of timeliness, cost consideration and need to avoid repetition of information previously reported. An interim financial report should include, at a minimum, condensed statement of financial position, condensed statement of comprehensive income, condensed statement of changes in equity, condensed statement of cash flows and selected explanatory notes (IAS 34).

Previous studies like Shores (1990) and McNichols and Manegold (1983) informed the importance of interim announcement as one of the main sources to obtain information for users, and they argued that interim reporting has become another important instrument that allows listed companies to communicate with its shareholders.

In Kenya all banks are required to present electronically their quarterly reports to the CBK and then publish a copy of un-audited financial statements in daily national newspaper. This should be done between Mondays and Fridays excluding public holidays at quarterly intervals (Peachey and Roe, 2008). The un-audited financial statements format is supposed to be similar to the audited financial statements. This allows investors to make timely decisions.

1.1.2 Stock Returns

This is the gain or loss of a security in a particular period. The return consists of the income and the capital gains relative on an investment. Investors use the information contained in financial reports thus share price behavior upon the announcement of financial report is significantly different from its behavior during other time. This response may generate abnormal returns.
Earnings announcements provide useful information to the investors. The capital markets react to information released and this leads to significant price changes in expectation of the actual earnings and thus stock returns (Jordan et al., 2012).

1.1.3 Trading Volume

Frazzini and Lamont (2007) indicated that stock returns and trading volume tend to be positively correlated. Trading volume tend to increase with increase in stock returns around the announcement date. Trading volume usually increases in response to earnings announcements, due to the reduction of information uncertainty among investors.

Some researchers have explained the relationship between volume and returns in the context of noise traders. Higher trading volume indicates the presence of irrational or noise traders, who push up prices (Baker and Stein, 2004). According to Like Lakhal (2008), quarterly earnings announcements are likely to increase trading volume around the day of the announcement, thus improving market liquidity and reducing information asymmetry.

1.1.4 Relationship between Interim Financial Statement Announcement, Stock Returns and Trading Volume

During recent years, the prevalence of individuals investing in stock market has increased heavily around the world. A common trend towards investing in shares has emerged as a result of a large amount of information, easier access to online trading facilities and favorable long-term price developments in the market. Additionally, lower trading costs and increased transparency have facilitated the broader market participation. A major
study by Dahmash et al, (2012), showed there is a significant positive relationship between interim financial reports announcement and stock returns around the announcement date and also a significant relationship between trading volume and stock returns around the announcement date.

A study by Ball and Brown (1968) on the impact of annual earnings announcements on share prices, found that earnings and financial components capture information that is contained in stock price. They concluded that trading strategies are often based on predictions of future earnings from publicly available financial statements information. The number of shares traded around the announcement date is likely to increase (Beaver, 1968). Similarly, Ziebart (1990) investigated the impact of quarterly earnings on the volume and share prices of companies listed on the New York Securities Exchange (NYSE), and found that quarterly earnings announcements contain information that affects both the price and the volumes of traded shares.

According to Bamber (1987) around the announcement date of financial statements there is a significant change in trading volume and share price. Some researchers argue that stock prices at the time of the announcement follow the direction and magnitude of the unexpected portion of the earnings disclosed in annual and interim financial reports. This effect on stock prices continues even after the announcement is made (Ball, 1992).

1.1.5 Nairobi Securities Exchange

Financial markets play a fundamental role in the economic development of a country. They are the intermediary link in facilitating the flow of funds from savers to investors. By providing an institutional mechanism for mobilizing domestic savings and efficiently
channeling them into productive investments, they lower the cost of capital to investors and accelerate economic growth of the country (Aduda et al, 2012). The Nairobi Stock Exchange (NSE) was constituted as a voluntary association of stock brokers registered under the societies Act in 1954. During the first three years of independence in 1963, the stock market experienced steady growth, rekindling confidence in the market.

In 1984, capital markets authority was formed to assist in the creation of an enabling environment conducive for the growth and development of the country's capital markets. In 1991 the Nairobi Stock Exchange was incorporated under the companies Act of Kenya as a company limited by guarantee and without a share capital. Subsequent development of the market has seen an increase in the number of stockbrokers, introduction of investment banks; establishment of custodial institutions and credit rating agencies and the number of listed company’s have increased over time. Securities traded include, equities, bonds and preference shares. (Kithinji and Ngugi, 2013). All listed companies at the NSE are required to provide interim financial reports at least as of the end of the first half of their financial year, not later than 60 days after the interim reporting date. Interim reports are supposed to provide less information as compared with annual financial statements due to the interest of timeliness, cost consideration and need to avoid repetition of information previously reported (Mathuva, 2012).

1.2 Research Problem

In the past users of financial statements rarely used quarterly reports to make their decision, however recently stakeholders have gained much interest on these reports as they believe they contain crucial information that guide them to make economic
decisions. As a result of this many countries mandate companies to adopt quarterly reports as a source of financial information to third parties (Al-Youqt, 2006). Previous studies like Shores (1990) and McNichols and Manegold (1983) informed the importance of interim announcement as one of the main sources to obtain information for users, and they argued that interim reporting has become another important instrument that allows listed companies to communicate with its shareholders.

Given the awareness of the usefulness of interim reports by investors, various researchers noted that there was market reaction around the announcement date, where change in stock prices and volume of shares traded was noted (Abed and Qabajeh, 2012), (Kangai et al, 2013). There have been some studies done in Kenya in the area of effect of financial reports announcement on the stock market. Kangai et al (2013), examined the effect of annual earnings announcement at the NSE by analyzing changes in share price and trading volumes, and their results indicated that abnormal returns and trading activity were not significant. Rono (2013) in his study noted that the market reacts positively to good earnings announcements and negatively to bad earnings announcements.

The thread with most authors was a keen interest on stock price reactions to annual earnings announcement and interim financial statement. According to Al-Yaqout, (2006), further research is needed to understand the effect of quarterly reports on share prices and traded volumes. In Kenya studies done related to this research have concentrated on the effect of quality financial reporting on investors decisions (e.g., Jamhuri, (2009); Kariuki and Jagongo, (2013), Okumu (2004), researched on the factors considered by individual investors in investing in shares of companies quoted at the NSE. However little research has been done on the effect of interim financial statements announcement on stock return
and volume of shares traded among listed commercial banks at NSE in Kenya, this study intends to fill this gap and answer the question: What effect if any does interim financial statement announcement have on stock return and volume of shares traded of listed commercial banks in Kenya?

1.3 Research Objectives

To evaluate the effect of interim financial statements announcement on stock return and traded share volume.

1.4 Value of the Study

By virtue that interim reporting is becoming very important to shareholders, this study will contribute greatly to the existing literature and will be very valuable to the academic fraternity and form a basis for further research on the effect of interim reporting on stock market.

This study will be of importance to investors, portfolio managers, decision makers and other stock market players who use earnings announcements to measure their trading expectations. Particularly, it is vital to investors in the baking industry in Kenya who can use the information generated in making sound financial and investment decisions regarding the sales and purchase of shares. They will also be able to know whether the company earnings are reflected in stock price.

This study will be of importance to government as it can use information generated by the study to better understand the importance of interim statements and the influence on investor decisions in the banking industry players. Initiate open forums, dialogue
channels and formulate more comprehensive policies to ensure industry players benefit from the full disclosures.

Managers of banks can use this study to determine whether investors rely on quarterly reports to make their investment decisions and take appropriate actions in ensuring that their reports contain quality information and are released on time.

Finally, the results of the study will provide feedback to the Capital Markets Authority (CMA) as a regulator of the capital market in Kenya. In acting as a watchdog for the entire capital market system, the CMA may utilize such findings in guarding against manipulation of share prices and insider trading.
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter presents the literature that has been done by other scholars on the areas of interim statements as a determinant of investor decision. This study will examine the importance of interim statements and whether investors rely on these statements to make their investment decision.

2.2 Theoretical Framework

Preparation and reporting of interim financial statements can be based on the following theories; efficient market theory, agency theory and signaling theory.

2.2.1 Efficient Market Theory

According to this theory, the management of a company is obliged to provide information to investors and other stakeholders to be able to appropriately make economical determinations in allowing them to make better predictions about the company’s future profitability and the firm’s cash flows(Scott 1997). According to Fama (1970), Market efficiency means that security prices reflect in totality all publicly available information thus eliminating any opportunity to make excess profits from available information because it is already captured in the market prices.

EMH assumes that investors are out to maximize their utility that agents have rational expectations and that whenever new relevant information appears, the agents update their
expectations appropriately. There are three forms of efficiency namely; the weak, semi-
strong and the strong form. In the weak form of efficiency, future returns cannot be
predicted from past returns or any other market-based indicator because the securities
reflect all the past information regarding price movement making it impossible for an
investor to use the same information to earn abnormal returns, (Paney, 2005).
In the semi-strong form of efficiency the security prices reflect all publicly available
information including the data in weak form. In the semi-strong form of efficiency high
level of fundamental analysis is required for the prices to fully reflect all publicly
available information including the data in the weak form. The strong form of efficiency
is the highest level of market efficiency whereby security prices reflect all public and
private information both published and the unpublished (Kangai et al, 2013).
There are three models of calculating abnormal returns under the semi-strong form of
EMH: the market model, the mean adjusted returns model-the Capital Asset Pricing
Model (CAPM) and the market adjusted returns model. Of the three, the market model
has been considered the best since it controls both the systematic risks and the
unsystematic risks of the stock. The strong form of EMH contends that stock prices fully
reflect all available information, both public and insider, and therefore no group of
investors has a monopolistic access to information relevant to pricing. As such, no
investor is able to consistently derive above average profits. The strong form thus
encompasses the weak and the semi-strong forms. Strong form of EMH requires not only
the assumption of efficient markets but also that of perfect market. In an efficient
market, no impact should be observable prior to the announcement, nor during the
days following the announcement. The price of stock should react immediately to relevant new information.

Pandey (2004) states that for the capital market to be efficient in the semi-strong form, the value of cumulative abnormal returns (CAR) should be equal to zero before the event, rise to a positive number just after the event and then stay put. In an inefficient market, the value of CAR will continue rising for several weeks after the event. This sub-hypothesis contends that share prices reflect all publicly and privately held information. It encompasses the weak and the semi-strong forms and represents the highest level of market efficiency. The market price fully reflects the true or intrinsic value of the share based on the underlying future cash flows (Arnold, 2005). The implication is that no investor, over a reasonable period of time, can earn abnormal rates of return by using publicity held information in superior manner.

EMH operates under a set of assumptions among which is the existence of a large number of profit maximizing participants concerned with the analysis and valuation of securities. These participants operate independently to each other. Moreover, it assumes that new information regarding securities comes to the market in a random manner, and the announcements over time are generally independent from one another. Third, investors adjust security prices rapidly to reflect the effect of new information. Finally, the security prices that prevail at any one point in time should be an unbiased reflection of all currently available information. Information in the EMH is defined as anything that may affect prices that is unknowable in the present and thus appears randomly in the future (Dixon & Holmes, 1996). Jones (1998) states that information is key in determining stock prices, and is therefore the central issue of the
efficient market concept. Vernimmen (2007) argues that the financial market will not fairly price a company’s securities unless that company provides relevant financial information. The market uses this information to assess the real capacity of the firm to create value. Financial communication reduces the information asymmetries between market participants. Information can be classified as historical, current or forecast, but only current and historical information is certain in its effect on price (Pike and Neale, 2003).

The EMH asserts that market prices adjust as new information is disseminated. In other words for security markets to be efficient, security prices must adjust rapidly (Mayo, 2006). If prices incorporate all known information and they change rapidly, day to day price changes follow a random walk over time.

### 2.2.2 Agency Theory

According to Jensen and Meckling (1976), agency theory models the relationship under which the principal (s) engage the agent to perform some services on their behalf which involves delegating some decision making authority to the agent. In the context of a firm, the agent (manager) acts on behalf of the principal (shareholder) (Eisenhardt, 1989).

Frequent disclosure presents an excellent opportunity to apply agency theory, in the sense that managers who have better access to a firm’s private information make credible and reliable communication to shareholders through interim reports to optimize the value of the firm (Eisenhardt, 1989).
2.3 Empirical Literature

Naser (2002) examined the Share Price Reaction to the Release of Financial Statements in the Stock Exchange of Saudi Arabia. This study empirically investigated the relationship between the share price reactions to the release of the annual financial statements by employing the market model. By using the five year data (1995 to 1999) with the event study methodology, this study revealed that the released financial statements influenced changing investors’ behavior.

A study done by Vieru (2000), on the impact of interim earnings announcements on share price showed that there was a price effect after the announcement. According to Szyszka (2001), information content of quarterly reports is reflected in stock prices. This was after conducting a study on the impact of quarterly reports announcements on stock markets in Poland and the results showed that there was a significant post-announcement drift of negative abnormal returns in the companies that unexpectedly reported highly disappointing quarterly earnings. A study done by Iqbal and Mallikarjunappa (2009), on the announcement effects of the stock markets, showed that stock market reaction to the earnings announcements was very slow.

A similar study was done by Babu (2008), on the impact of quarterly reports on share prices. The prices of stocks before the announcement were compared with stock prices after the announcement using independent sample T-test. Additionally change in prices was also compared to an increase in profits reported in the quarterly results. The study results showed that there was an increase in price after the results, and that an increase in price was mainly due to market conditions rather than the announcement of quarterly
results. The increase or decrease in share prices was not reflected in the growth in profits announcement in the quarterly results.

A study by Rono (2013) examined stock market reaction to annual earnings announcements using the data from the Nairobi Securities Exchange (Kenya) and JSE Securities exchange (South Africa). The period of study was 2005 to 2011. Using the event study methodology, the magnitude of market reaction to the earnings announcements for a sample of 261 listed firms on NSE and JSE was tested. Abnormal returns (ARs) were computed for each firm and tested how announcements impact a firms’ share price. The results showed positive and significant returns on the announcement month for JSE, whereas the returns for NSE were negative and significant on the second month after announcement.

Eleke and Opoku (2013), in their study examined the effect of earnings announcement on Ghana Stock Exchange (GSE) by analyzing changes in share prices for the period 2010 to 2013. They selected ten listed companies and used event study methodology. Their results indicated that abnormal returns around the earnings announcement were not significant at a 5% margin of error and the insignificant cumulative average abnormal returns surrounding the event date were inconsistent with EMH. They concluded that earnings announcement depicted no major effect on share prices of companies at the time of the announcement as well immediately after the announcement.

Kiger (1972) investigated the effect of quarterly reports on the volumes and share prices of listed companies on the New York Stock Exchange, and concluded that quarterly reports information affects the volume and price of traded shares. Additionally Link et al,
(2012) quoting Cuijpers and Peek (2010), found that quarterly reporting leads to higher share liquidity and an increase in trading. They argued that this was due to availability of useful information to investors contained in the interim reports. A study done by Behrouzi, (2013) on the influence of publishing quarterly financial statements on stock price in listed firms on Tehran stock exchange showed that share price one week before and one week after reports publishing date will increase or decrease. Mensah, (2006) also found evidence that quarterly reporting results in greater stock price volatility that semi-annual interim reporting.

Qabajeh et al (2012) studied the effect of interim financial reports announcement on stock returns of Jordanian industrial companies. The study examined the stock returns during five trading days before and five trading days after the announcement date from 2010 to 2011. The conclusion was that there was a significant relationship between interim financial reports announcement and stock returns around the announcement date. Similarly according to Morse (1981), around the announcement date of financial statements there is a significant change in trading volume and share price. Some researchers argue that stock prices at the time of the announcement follow the direction and magnitude of the unexpected portion of the earnings disclosed in annual and interim financial reports. This effect on stock prices continues even after the announcement is made (Ball, 1992).

Afego (2011) examined the stock price response to earnings announcement in the Nigerian Stock Market (NSM) using the event study method. The results showed that there was a cumulative abnormal return 20 days before the earnings release date. They
concluded that a portion of the market reaction was due to private and possibly, abuse of information by insider and thus Nigerian stock market was not efficient.

In Kenya a similar study was done by Kangai et al (2013), on the effect of annual earnings announcement on the share price and trading volume of 5 listed companies at the NSE for the period from 2006 to 2010. They used the event study methodology to get the abnormal return for an event window of 91 days. Further, the volume reactions were examined using the trading activity ratio. The results showed that abnormal returns and trading activity were not significant. They concluded that NSE is of semi-strong efficiency, thus not possible to earn abnormal returns in the NSE using the publicly available information. In contrast a study done by Kakiya et al (2013) on the effect of earnings announcement on the level of efficiency of the NSE. The study used the closing share prices and traded volumes for 15 days before and after earnings announcement for year 2007. The results indicated that earnings announcement had a significant effect on stock return and thus it was concluded that the NSE is not semi-strong form efficient.

2.4 Summary of Literature Review

Many studies undertaken in various stock markets in the world produced mixed results. In many of the studies, earnings announcements led to change in share price and trading volume. For instance, Morse (1981) carried out a research on market reaction to earnings announcement and found abnormal returns around the announcement date. Some studies found that markets did not react. Eleke and Opoku (2013) observed that there was no effect on the market when earnings announcements were made. Iqbal and Mallikarjunappa (2009) found that the effect on the stock market due to earnings
announcement was very slow. This uncertainty about the real effect of earnings announcements on stock prices is the main reason why the researcher intends to undertake this study.

Moreover, most of the studies that have been undertaken on market reaction to release of financial reports were done outside the Kenyan market. The studies done in Kenya have been too few to give a conclusive result and hence the need to carry out this research. Kangai et al (2013) and Kakiya et al (2013), studied the effect of annual earnings announcement on stock price and volume at the NSE and their results were contradictory despite both being carried in Kenya. Kangai et al (2013) found that the abnormal returns and trading activity were not significant before and after the annual earnings announcement date while Kakiya et al (2013) indicated that earnings announcement had a significant effect on stock return. Thus more research is paramount to resolve the controversy.

Also, market reaction elicited by earnings announcements as shown by studies done in other countries cannot be generalized to the Kenyan market because of differences in stock market activity, varying economic growth levels, diverse political environments, among others. Hence, there exists a gap.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research design that was used in the study. It shows the sampling techniques of the target population, data collection techniques and the methods that were used and the way data collected from the industry was analysed. This section specifies the framework or blue print for the entire research that enabled the researcher to achieve the objectives of the study.

3.2 Research Design

According Cooper and Schindler, (2011), a research design is the blue print for fulfilling objectives and answering questions. The research design therefore describes the procedure that is followed in conducting the study. The standard event-study methodology was used to evaluate the market reaction to interim earnings announcement by listed commercial banks at the NSE from 2009 to 2013. Event methodology is viewed as a powerful tool and many researchers (Rono 2013); Kangai (2013); and Pyemo (2011) successfully utilized the event study methodology to determine how share prices react to new information released in the market. Abnormal returns were calculated around the event date using the market model and were used to determine the level of the market’s efficiency. The concept of abnormal returns coupled with the notion that information is readily impounded into security prices is the central key of event study methods (Serra,
2002). Share price considered as a dependence variable and the information contents of the annual financial statements considered as independence variable.

3.3 Population

The target population in the study was the listed commercial banks at NSE. Data that was available from NSE (2014) revealed that there were 11 listed commercial banks in Kenya. Due to constrained resources, this study focused on 3 listed commercial banks. This population was relevant for this study since it provided the necessary information needed for the research topic. It also facilitated attaining desired objectives of the study.

3.4 Sampling

Sampling is a means of choosing a representative group of the population to help in testing for particular characteristics to infer to the entire population. The sampling frame consisted of 11 listed commercial banks at NSE. The sampling design was convenience sampling. The sample size was selected based primarily on the criteria of the only companies that had been listed and actively traded throughout the study period from 2009 to 2013. Also, since most listed companies at NSE announce their earnings and dividends simultaneously, only companies which had earnings and dividend changes in the same direction was selected, in order to control for the effect of dividend announcements.

Further, all companies whose event date was not be obtained was eliminated from the study. To eliminate the problem of confounding effects, all companies that had a major event during the event window was eliminated from the study. Confounding effects occur when multiple noteworthy events occur on the same announcement dates making it impossible to determine the event that caused the after announcement stock price (Mc
Examples of these include mergers, management changes and stocks split. The earnings announcement dates and major events were identified by carefully studying the NSE handbook, the NSE daily trading information and the companies’ newsletters.

3.5 Data Collection

The study used secondary data from the NSE relating to interim earnings announcements, daily share prices, daily traded volumes and NSE 20 share index covering all the days in the event window for the period from 2009 to 2013.

3.6 Data Analysis

The market model was used to calculate the daily abnormal returns. The study considered an event window of 15 days focusing on 10 days before the event \((t = -10)\) and 5 days after the event date \((t = 5)\) with the event day represented by \(t = 0\). The 15 days period was sufficient for the estimation of the abnormal return of the model with good level of accuracy based on previous studies that carried out research on a similar period. The estimated period was 50 days.

Daily share return of each company was calculated according to the following equation.

\[
R_{it} = \frac{P_{it} - P_{it-1}}{P_{it-1}} \quad \text{..................(1)}
\]

Where; \(R_{it}\) = return on share \(i\) on day \(t\)

\(P_{it}\) = price of share \(i\) on day \(t\)

\(P_{it-1}\) = price of share \(i\) on day \(t-1\)
Daily expected return was estimated using the Market Model for each share as follows.

\[ E(R_{it}) = a + b(R_{mt}) \] ..........................(2)

Where;

- \( E(R_{it}) \) = expected return on share \( i \) on day \( t \)
- \( R_{mt} \) = return on the market on day \( t \)
- \( a, b, \) = are parameters of the market model

In order to test the market reaction to the announcement of quarterly reports, abnormal return was calculated before and after announcement. It was calculated as the difference between the actual return on share \( i \) on day \( t \) and the expected return on share \( i \) on day \( t \) according to the following equation.

\[ AR_{it} = R_{it} - E(R_{it}) \] .......................... (3)

Where;

- \( AR_{it} \) = abnormal return on share \( i \) on day \( t \)
- \( R_{it} \) = return on share \( i \) on day \( t \)
- \( E(R_{it}) \) = expected return on share \( i \) on day \( t \)

To generate the expected return by the market model, the Ordinary Least Square (OLS) technique was employed. A regression was run on the daily share return for each firm in the sample surrounding the release of its financial statements against the daily market return, as proxied by the market index for the corresponding calendar day. The parameters of the market model were estimated over a 50-day estimating period, from day \( t - 50 \) to day \( t - 10 \). This 50-day period was in the range recommended by Strong (1992) and other previous studies in this area.
The abnormal return data was analyzed by Statistical Package for Social Sciences (SPSS). Data was analyzed by descriptive and inferential statistics and significance tested by T-test. The level of significance was set at 5%.

The Abnormal return was the percentage of change in share price below or above what would normally be expected to occur. To improve the informativeness of the analysis of abnormal returns, we average the ARs across the observations for all events, N, using the following equation.

\[ AAR_t = \frac{1}{N} \sum AR_{it} \] ………….(4)

Where; \( AAR_t \) = Average abnormal return at day t

\[ N = \text{Number of events in the sample} \]

\[ AR_{it} = \text{Abnormal return for share } i \text{ at day } t \]

In order to make generalizations and to draw on overall inference for the market reactions to earnings announcement, the cumulative abnormal returns was also analyzed for the 15-day event window, from the start of the event period t-10(day -10) up to time t+5(day +5) as follows.

\[ CAAR_t = \sum AAR_t \] ……………………………(5)

Where;

\[ CAAR_t = \text{Cumulative abnormal return of day } t \]
\[ \sum_{i} \text{AAR}_t = \text{Sum of Average abnormal return of day } t-5 \text{to } t+5 \]

The CAARs for each stock was obtained by summing average abnormal returns (AARs) over the event window.
CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents the data findings on the effect of interim financial statements announcement on stock return and traded share volume. These data were collected from the NSE offices and analyzed using Excel and SPSS (version 17). Analysis involved evaluation of daily abnormal return and establishing the relationship between financial statements announcement and stock return and traded share volume. Within the 5 year period of the study, 3 commercial banks listed in NSE were analyzed and these were Barclays bank, Equity bank and Standard chartered bank. The cumulative abnormal returns was analyzed for the 15-day event window, from the start of the event period t-10(day -10) up to time t+5(day +5). Event date is date of announcement of the interim financial statement.

4.2 The Stock Returns Reaction to Interim Earnings Announcement

The market model was used to calculate the abnormal returns (AR) and cummulative abnormal return (CAR) during the event window. The study analysed the the difference between actual returns of company at event window and the expected returns to establish the abnormality of returns following interim financial statements announcement. The average AR for the three banks were fitted in a time plot to establish the trends.
The figure above showed the statistical evidence on whether or not there is information contents in interim statements of Barclays bank. In efficient market theory no one can earn abnormal returns since the information is fully impounded into prices.

The above graph indicated that abnormal returns tended to rise 2 days before the interim earnings announcement and then dropped on the event date. It also indicated that the average abnormal returns tended to rise immediately after the announcement except day 2 and 3. The sudden increase in abnormal return in post financial statement announcement date implied that Barclays bank interim financial statement was favorable thereby attracting more investors. Share prices increased resulting to more investment through increased stock return. The findings were consistent with Dahmash et al, (2012)
who contended that there is a significant positive relationship between interim financial reports announcement and stock returns around the announcement date.

Graph 2: Average AR of Equity bank

Source; Research Findings

In the graph above there was a steady increase in abnormal returns from -0.06 in day-2 to 0.045 at the event date. This meant that there was leakage of relevant information to a small group of investors causing abnormal returns on the event date. The findings confirmed Bamber (1987) who argued that around the announcement date of financial statements there is a significant change in share price. Ball (1992) stated that stock prices at the time of the announcement followed the direction and magnitude of the unexpected portion of the earnings disclosed in annual and interim financial reports. This effect on stock prices continued even after the announcement was made.

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Graph 3: Average AR of Standard chartered bank

Source: Research Results

The above figure showed that the average abnormal return was negative during post announcement days except day 3 and 5. The negative AR reported was because investors took time to analyze the information contained in interim financial statements and hence no investor earned extra return. This is consistent with Beaver (1968) who found that stock market reaction to the earnings announcements was very slow.
Graph 4: Analysis of Cumulative Average Abnormal Returns for the Release of Financial Statements

The graph below showed the CAR of the sample listed commercial banks. It depicts that the CARs over the entire event window period were positive except day -3,-2 and -1. From the above analysis, it was inferred that investors anticipated that the financial statements might have favorable information, hence reacted positively during pre and post announcement period.
Graph 5: The Trading Volume Reaction to the Annual Earnings Announcement

The results of Trading Activity Ratio (TAR) were presented in the figure below.

Source: Research findings

The figure above showed that TAR 2 to 3 days before the announcement date demonstrated a sharp increase due to anticipated positive results. At day -12 to -10 pointed speculator activity coupled with reduced supply or demand during the preceding days. The peak after the announcement illustrated an increase in TAR that was better reflecting the financial results of the firms.
4.5 Average Value of Security Return Variability for Interim financial statement Announcement

<table>
<thead>
<tr>
<th>Estimation Period</th>
<th>Security Return Variability</th>
</tr>
</thead>
<tbody>
<tr>
<td>From day -50 to day -15</td>
<td>1.590992</td>
</tr>
<tr>
<td>From day -15 to day -1</td>
<td>1.591772</td>
</tr>
<tr>
<td>From day +1 to day +5</td>
<td>2.86806</td>
</tr>
</tbody>
</table>

Source: Research Findings

To analyze the speed at which the stock market absorbed the interim financial statements announcement in its prices, the study presented the average security return variability across the announcement periods as shown in table 4.5. As indicated by the table, stock variability was more in post announcement period than pre-announcement period; while t-50 to t-15 had ASRV of 1.590992, t-15 to t-1 had ASRV of 1.591772. Between t+1 and t+5 the ASRV was 2.86806. Therefore, the stock market positively absorbed the information contained in interim financial statements positively.
CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter discussed the summary of the findings in chapter four. Conclusion and recommendations drawn from these findings were discussed in relation to the objectives of the study to establish the effect of interim financial statement on stock return and traded volumes for the 11 listed commercial banks at the Nairobi Securities Exchange.

5.2 Summary

The study employed an event study methodology where the impact of interim financial statement on stock return was investigated for an event window of 15 days, 10 days before the announcement and 5 days after interim earnings announcement. The study covered a period between 2009 and 2013. Analysis of the companies’ stock returns reaction to interim financial statements gave a mixed result.

Barclays bank of Kenya limited recorded low stock returns during the pre interim financial statement announcement date. However, there was sudden increase in stock returns in post financial statement announcement date.

There was a steady increase in returns for Equity bank just before the event date. The increase in return at around interim financial statement announcements was attributed to anticipated share price increases.
The result indicated that there was negative abnormal return for Standard Chartered bank during post interim financial statement announcement. This implied that investors took time to analyze the interim announcements before taking investment decisions.

The traded volume increased 2 to 3 days before announcement as investors anticipated better results with reduced trading activity on the event date. TAR increased 2 days after the announcement following investor analysis of the results.

The findings further showed that the variability in stock prices increased erratically with days preceding and after interim financial statements. This meant that some investors earned above normal returns.

The regression result also established positive association between security return variability and market price per share. Security return variability increased the market price per share. At 5% level of confidence, security return variability positively affected market price per share. A unit increase in the variation in security return variability led to 0.1195 units increase in market price per share.

5.3 Conclusions

Interim financial statements announcements were informational events that caused increases in stock return. It was concluded that these events (interim financial statements announcements) caused a general increase in stock returns. Given roughly 50-day period, the effect of interim financial statements announcements on stock prices persisted for an average period 10 days. Interim financial statement announcements affected stock returns almost immediately. It was also established that the companies share returns exhibited erratic positive returns before and after the announcement. This changed drastically with
interim financial statement announcement from day 3. Hence, the information made by
the companies was useful for valuing the securities. The study also found that some
investors made abnormal returns at some point during post-announcement period most
likely having used information in the interim financial statements.

Therefore, the study concludes that the security prices react to interim financial
statements. The results support the semi- strong form efficient market hypothesis since
stock prices adjust to public information though not fast enough that no investor can earn
an above normal return by trading during post announcement period especially between
day t1 and t3. However, some period after the announcement have above normal returns.
5.4 Recommendations

From the study findings, it was established that interim financial statement positively impacted the stock returns and trade volumes therefore the policy on this event may need to be reviewed by CMA to encourage firms to adopt interim financial statement.

Secondly, to reduce abnormal reaction of prices caused by speculative trading by retail investors, the public should be educated on the operations of NSE in a bid to encourage more long-term investments than short-term ones as well as impart knowledge on the public regarding stock market activity.

NSE should maintain a record of the dates of various events and make the information available to encourage scholars to undertake research on these events. That way, they will gain from the research and researchers would have easy access to information regarding interim financial statement. CMA should ensure compliance with insider trading laws, guidelines, rules and regulations by effectively monitoring the market. This will eliminate incidence of collision between brokers and traders, insider trading and leaking information and hence boosting investor’s confidence.

5.5 Limitations of the Study

The study was limited by a number of ways. First, among the listed commercial banks not all firms declared results as is requirement of laws, rules and regulation. This meant that the intended number of the banks as listed could not be studied.
Availability of data from NSE was a challenge, and one needed finances to access data. Other limitations were inadequate time for data collection and data analysis. My work schedules were very tight thus not getting enough time to do the research.

5.6 Suggested Areas of Further Research

The study recommends that a similar study can be done on other corporate events like bonus issue, merger and acquisitions, cross listing, rights issues so as to determine how the stock market reacts so as to be in a position to conclude whether Kenyan stock market is efficient in the semi-strong form as different events conveys different information.
REFERENCES


APPENDICES

Appendix: List of listed commercial bank in Kenya

Barclays Bank Ltd

CFC Stanbic Holdings Ltd

I&M Holdings Ltd

Diamond Trust Bank Kenya Ltd

Housing Finance Company Ltd

Kenya Commercial Bank Ltd

National Bank of Kenya Ltd

NIC Bank Ltd

Standard Chartered Bank Ltd

Equity Bank Ltd

Co-operative Bank of Kenya Ltd

Nairobi Securities Exchange: JUNE 2014