ELSEVIER

Available online at www.sciencedirect.com

ScienceDirect

Procedia - Social and Behavioral Sciences 189 (2015) 163 – 168

Procedia
Social and Behavioral Sciences

XVIII Annual International Conference of the Society of Operations Management (SOM-14)

Return volatility around national elections: Evidence from India

Savita[a] *, A. Ramesh[a]

[a]*Department of Management Studies, Indian Institute of Technology Roorkee, Roorkee, Uttarakhand-247667, India*

Abstract

This paper analyses the share price performance around National elections in India during the 2014 general elections. Due to change in the market sentiment, the stock prices react to the changes in the government. We investigate shareholders' returns around national elections for 30 companies of BSE SENSEX. Stock prices have been observed over different event windows like (-15, +15), (-2, +2), (-15, -2), (+2, +15) days around the event date. Event study methodology has been used to analyze the results. High positive CAAR (cumulative average abnormal returns) has been observed over different event windows, which reflect market has positively reacted to the possibility of a change in government and after election of a new government.

© 2015 The Authors. Published by Elsevier Ltd. This is an open access article under the CC BY-NC-ND license
(http://creativecommons.org/licenses/by-nc-nd/4.0/).
Peer-review under responsibility of the scientific committee of XVIII Annual International Conference of the Society of Operations Management (SOM-14).

Keywords: Cumulative abnormal returns; Shareholders; Event study; National Elections.

1. Introduction

Political cycles affect the economy and financial market in many ways. Politics is important in various forms. They shape the institutions and regulations that are relevant for finance, be they courts, taxes, administrative efficiency, fiscal policies, corruption or expropriation risk. The relationship between behavior of investors and politics relies on the concept of political risk, which is defined as the unfavourable changes in public policy that affect investment values (see, among others, Brooks and Mosley, 2008). Investors try to evaluate this risk as best as possible, but uncertainty is reflected in times of political change and in particular during elections (Bernhard and Leblang, 2002).

* Corresponding author. Tel.: +91-8267852070.
E-mail address: savidddm@iitr.ac.in

1877-0428 © 2015 The Authors. Published by Elsevier Ltd. This is an open access article under the CC BY-NC-ND license
(http://creativecommons.org/licenses/by-nc-nd/4.0/).
Peer-review under responsibility of the scientific committee of XVIII Annual International Conference of the Society of Operations Management (SOM-14).
doi:10.1016/j.sbspro.2015.03.210

Shiller (1981) has argued that observed stock market volatility is not consistent with the predictions of different present value models. Hence drivers which drive volatility need to be identified and evaluated. There are various other factors which contribute to volatility. Schwert (1989) has investigated empirically if the aggregate stock return variability can be linked to different macroeconomic variables, financial leverages, and trading volume. He has concluded that only a small proportion of the variations in the market volatility are possible to explain.

Political factors in general and political uncertainty in particular, can influence both the return and risk levels of financial assets (Gemmill, 1992). Bialkowski (2008) showed in his paper that stock markets can become very unsettled during the times of important political changes. From literature, a negative relationship between financial asset valuations and level of uncertainty regarding the economy has been reported.

The in-depth analysis into return volatility surrounding elections is important due to three important reasons. First, the uncertainty about the election outcome has important implications for risk-averse investors. Earlier research indicated that investors are usually not diversified internationally and have a string home bias (French and Poterba, 1991; Baxter and Jermann, 1997). So they tend to hold more domestic assets which mean the country-specific political risk will not diffuse in their portfolios. Hence in the case of elections in the home country, it will have significant implications for the risk level of their portfolios. Second, any market-wide fluctuations in response to election shocks will lead to increase in the systematic volatility of all listed stocks. Therefore it is evident that when voters go for casting their ballots, option prices could increase around that time.

Also, volatility hikes which are observed around an Election Day or declaration of results would indicate that the efforts to formulate precise predictions should be furthered and additional resources need to be employed to resolve this issue.

2. Literature Review

Previous studies on the relationship between politics and stock markets have focused on systematic risk induced by political factors, without analyzing firm-specific risk. Therefore, it is unknown how increased political risk around national elections influences firm-specific performance. Change in the government will result in change in important macroeconomic policies which can lead to changes in the key management of the firm. Event study methodology will examine the performance of the firms around national elections.

Hensel and Ziemba (1995) have documented that small-cap stocks have significantly higher returns during Democratic administrations as opposed to Republican administrations. Gemmill (1992) reported that implied volatilities move upwards in the last week before elections. Gemmill also reported that opinion polls were connected to the stock market indexes as well as market volatility.

This study is important for different reasons. The presence of abnormal returns surrounding election events can affect the portfolio decisions of investors. Uncertainty related to election outcome has also important implications for investors, especially when risk averse (i.e. 'hedgers') and risk loving investors (i.e. 'speculators') can use instruments like derivatives instruments to eliminate or take advantage of the increased volatility of returns. Additionally, evidence suggests that investors do not diversify internationally (Baxter & Jermann, 1997), and thus political risks are not diffused within portfolios.

The remainder of this paper is organized as follows. Section 2 has discussed the existing literature, empirical investigation of the theories, and studies of stock market behaviour around important political events. Section 3 provides an overview of the datasets which are employed in this paper, and introduces the event study methodology used to analyze returns and volatility around the election date. Section 3 also introduces the hypotheses that will be tested, whilst Section 4 discusses the key findings. The robustness of results is also examined in Section 4. Section 5 summarizes the conclusions to be drawn from this paper.

3. Objectives, Data and Methodology

The objective of the present paper is to examine the short term abnormal returns of the stocks listed on the BSE SENSEX. The hypothesis for the study is:

H_1: The shareholders of the sample firms earn positive/negative abnormal return in the short-run.

Download English Version:

https://daneshyari.com/en/article/1109866

Download Persian Version:

https://daneshyari.com/article/1109866

Daneshyari.com