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IMPACT OF GENERAL ELECTION 2013 ON THE SHARE PRICES OF PUBLIC LISTED FIRMS: EVIDENCE FROM PAKISTAN.

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ABSTRACT

This study investigates the impact of the general election 2013 on share prices of public listed firms of Pakistan. To analyze, least square regression model is used as the research methodology. The sample of the study includes 50 randomly selected companies from the Karachi stock exchange. The results of the study highlight that share prices of public listed firms of Pakistan responds negatively to such political events. The results further highlight that share prices of large sized and highly levered firms observed more positive changes during the general election 2013. Further, the share prices of more profitable firms experienced low volatility than less profitable firms. The findings of the study have policy implications for manger and investors.

Keywords:

INTRODUCTION

The stock exchange (stock market) is a place, where the shares of listed companies of a country are traded (Gul, Khan, Saif, Rehman, & Roohullah, 2013) . In the stock market, secondary securities (already issued) are traded. Stock market is an essential part of the financial system of a country. These are often considered as barometers of an economy, because they show the change as well as the direction of an economy (Srivastava, 2010). It also plays a very important role in making the economy efficient as it ensures the liquidation of the primary market, where the funds are channelized from surplus sector to deficit sector. Stock market measures that how a country is performing domestically and internationally (Gul, et al., 2013).There are currently three stock exchanges in Pakistan, namely; Karachi stock exchange, Lahore stock exchange and Islamabad stock exchange. Karachi stock exchange is the biggest among them, as 75 to 80 percent trade takes place through it (Javid, 2007) .

The price of a single share of the common stocks outstanding of a company is called stock price. Stock price indicates the efficiency of management and board of directors, and represent strength of the overall company. A continuous rise in the stock price saves the management from firing, and the company from takeover (Hunjra, Shahzad, Chani, Sabih ul Hassan, & Mustafa, 2014).

Stock prices are volatile and changes on daily basis either in positive or negative directions. Various factors affect the stock prices, for example, natural calamities, disasters, political events, terrorist's events, corruption, economic inflation and recession(Gul, et al., 2013). Stock prices are also sensitive to some internal factors such

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as, dividends announcements, earning per share, return on equity and profit after tax (Hunjra, et al., 2014).

Political events cause volatility in stock prices of companies. Presidential elections and general elections are political events and during these events the stock prices show variations. Stock price behavior are studied during presidential elections in developed countries like United States, United Kingdom and Germany, but the results are not generalizable for Pakistan, because of differences in political system, tax system, institutions, technological system, financial system and some other differences. Some developing countries also have such type of studies, for example (LIU 2007, Omar Masood and Bora Aktan 2010 andGul et al 2013). But the stock price behaviors during the elections are not thoroughly examined yet and are still remains debatable.

Stock prices behavior during political/ general elections was examined on an international scale by researchers, for example Bialkowski, Gottschalk, and Wisniewski (2008) and Pantzalis, Stangeland, and Turtle (2000), but the stock price behavior of a single country around a single general election is not yet studied up to the best level of researchers knowledge. The study is carried out to fill this gap in the existing literature, byanalyzing the stock price behavior of Pakistani listed firms during the general election 2013. The researchers are interested to study the impact of 2013 election, because it was the first general election in Pakistan when the power was delegated politically to the new elected government by the previous government after the completion of its five years tenure. Almost all the political parties took part in the election for the first time.

Profitability, leverage and size are firm's specific characteristics, which have an impact on stock prices of organization during events. The role of these variables on the stock prices is not yet analyzed during general elections. Therefore, the researchers are intended to find out the impact of the above mentioned variables on the stock prices of Pakistani public firms around general election 2013.

General election 2013 is different from the previous elections held in Pakistan. This election was held in a fully democratic environment, almost all the political parties took part in it and the election was on its own time. For the first time the previous politically elected government completed its tenure and transferred power to the new elected government. This time the caretaker government was impartial because it was made by mutual consensus with the opposition. Though rigging blames were there, but unlike previous, large scale intuitional rigging was not observed this time. And at last, usually two political parties had been contested at national level in the history of Pakistan, but this time the third big player (Pakistan Tehrek e Insaaf) was also in the field and its slogan and manifesto was also different.

LITERATURE REVIEW

Efficient market hypothesis states that stock prices in an efficient market represent all available information, and no investor can earn abnormal returns(Fama, Fisher, Jensen, & Roll, 1969). Although the theory of market efficiency is a renowned theory in the real world, but various studies have found stock price anomalies during political and other events(LIU, 2007). LiargovasandLiargovas(2010) utilized event study methodology to examine stock price responses of Greek banks to three international terrorist events. Significant negative abnormal returns were found in response to September 11th attack and London terrorist attack, while the impact of Madrid attack on the stock prices was

not significant.Gul, et al., (2013) concluded after examining the impact of political events, terrorist events and natural calamities on KSE (Pakistan) listed financial firms that, stock prices responded negatively to such events during the period of 2007-2010. The stocks listed at Karachi stock exchange show both the positive and negative response to the earthquake of October 8, 2005. The returns and volume of cement, steel, food and banking sector rose because of the investor's expectation of high demand for investment in these sectors after the unanticipated event. Some companies experienced negative stock return volatility such as National refinery, Faisal Spinning, Fauji Cement, Metropolitan Steel,Mirpurkhas Sugar and Mandviwala Plastic. The expectation for the foreign aid also helped the market to recover(Javid, 2007).

Zach (2003) examined the stock price relationship to political events of firms listed on Tel Aviv Stock Exchange (Israel) from 1993 to 1997. The researcher found that stock prices are more volatile on event day as compared to normal days. The direction and intensity of volatility depends on the nature of political event. For example stock prices show high positive volatility during the Oslo accord (good news), while it was high negative in response to interest rate rise (bad news) during this period. Beaulieu, Cosset, &Essaddam(2005) carried out a study based on stock returns volatility of Quebec based firms and Canadian firms in relation to political news during 1990-1996. The researchers argued that unfavorable political news increases the stock returns volatility of firms exposed to political risk, while favorable political news reduces this volatility. The effect of unfavorable news was higher than favorable one because of greater informational content and media coverage. According toOrtegaandTornero(2009), stock price volatility increases with the arrival of elections. They concluded that before and during election the Spanish stocks experience negative abnormal returns, because of high uncertainty about the new policies. The stock prices rise just after the election, because the uncertainty is resolved.

LIU (2007) studied the stock market behavior of five East Asian countries namely Taiwan, South Korea, Singapore, Philippines and Indonesia around presidential elections for the period of 1996-2005, using event study methodology. The researcher found positive returns for fifteen days before and fifteen days after these elections. The factors influencing the uncertainty (a country's political, economic and press freedom, election timing and the success or failure of incumbent) determine the level of abnormal returns. For example the stock returns in countries of little political and press freedom were highly abnormal during elections. The stock market response is observed to be greater during elections in which the incumbent lose, because these elections lead to change of ruling party and results in a large amount of uncertainty.

Pantzalis, et al., (2000) found positive abnormal returns, by investigating the behavior of stock market indices of 33 countries, around political elections for the period 1974-1995.The researchers argue that these positive returns are function of country's specific characteristics, such as degree of political, economic and press freedom, election timing and success of the incumbent to be re-elected. Particularly, strong positive abnormal stock returns found during elections won by opposition in less free countries, and during early elections lost by incumbent government.

The impact of political events is examined on stock prices and trading volume, on KSE 100 index (Pakistan) from February 2008 to February 2009 by Malik, Hussain, and Ahmed (2009). The study is based on the resignation of Ex Pakistan's president Pervez Musharraf. The researchers found the stock market responsive to such events, and

concluded that stock prices and trading volumes are more positive in the post resignation period than the pre resignation one.

Stock price behavior in relation to political variables is studied by(Wisniewski, 2009). The researcher concludes that the US firm's stock prices are more expensive during democrats, and further found that stock prices move up during presidential elections, arguing that this price hike is caused by the promises made by presidential candidates. The findings of Snowberg, Wolfers, andZitzewitz(2007) are in strong contrast to Wisniewski (2009), which conclude that stock prices show positive movements during mid term election. This upward movement (though it was smaller than during presidential election movement) was because of republicans majority in the house and senate. The same study is carried out byDöpke andPierdzioch(2004) in Germany. They found that stock market favors conservative government rather than liberal in Germany, which are in contrast with those found in USA. The results also do not support the findings that political cycle has an impact on stock market; rather stock market returns affect political variables such as popularity of the incumbent government, and predict the election outcomes. According toBialkowski, Gottschalk, and Wisniewski (2007), the anomaly observed in the United States is country specific. The researcher found no significant difference among the returns of left wing and right wing government, using a sample of 24 OECD countries.

Goldman, Rocholl, and So (2006) investigated the impact of political events on stock prices after dividing US firms in two groups; firms politically connected with Democrats and firms politically connected with republicans. The results showed that stock prices of firms politically connected with Republicans rose in response to republican's victory in presidential election in 2000, while that of democrats connected firm's stock prices fall. Kim, Pantzalis, and Park (2012)has also carried out such type of study. The researchersanalyzed the political alignment index (PAI) as a determinant of stock prices around presidential and midterm election for US for 40 years. The conclusion supports the findings of Goldman, et al.(2006), that firms benefit from political connectedness, and avoid exposure to policy risk.

Bialkowski, Gottschalk, and Wisniewski (2008)investigated the impact of national elections on stock market using a sample of 27 OECD countries. The researchers utilized event study methodology, and conclude that elections induce volatility in stock markets, the volatility magnitude being the function of country's specific variables, such as tough contest among candidates, absence of significant voting laws, failure to form a coalition government and possible government transition. These variables lead to uncertainty, which is resolved on polling day, and result in moving up the stock market.

In United States the firm performance during elections decreases due to misallocation of capital and political uncertainty. The stock prices become less informative and the investors hesitate to respond to high stock prices during elections. Political related firms/ state owned firms stock prices are unbelievable, because they over invest in contracting sectors during election days for the purpose of gaining full employment(Durnev, 2011).

The stock market performance decreases during political grid lock (when political party controlling congress is different from the political party of the president) in the United States. The party(democrats/ republicans) effect on stock market is insignificant as it gives no clear result(Beyer, Jensen, & Johnson, 2004).

Empirical studies also show relationship between size and stock price volatility of an organization during events. For example Duffee(1995) argues after examining the stock price volatility in relation to firm size, that stock prices of small size firms are more volatile than large size firms when exposed to same shocks.Abnormal returns are negatively related to size of the firms, which means that abnormal returns are higher for small size firms even large size firms average returns are more than small firms(KEIM, 1983).

The profitability of an organization also affects its share prices. Hunjra, et al. (2014)examines the stock price volatility of 63 firms listed at Karachi stock exchange (Pakistan) in relation to dividend yield, dividend payout ratio, return on equity, earning per share and profit after tax for the period 2006-2011. The researchers used ordinary least square regression model, and found that earning per share and profit after tax have significant positive relationship with stock prices, which means that firms with high earning per share and high profit after tax have high stock prices. Both of these variables are indicators of profitability of a firm, therefore the profitability and stock price have positive relationship.

According to Wei and Zhang (2003) the profitability and stock returns volatility are negatively related, which means that the firms with high profitability exhibit low stock returns volatility. The researcher uses return on equity as measure of profitability.

The leverage level of an organization affects its stock price during events. For example Lang andStulz(1992) examines the impact of bankruptcy announcement on the stock prices of competitive industry. The researchers conclude that the bankruptcy announcements negatively affect the stock prices of the rival firms, and this effect is greater for the firms with higher leverage level. Stock returns volatility is positively related with leverage of the organization. When the organization issue more debt or its stock prices fall relative to bond prices, its stock returns volatility rises(Schewart, 1989). According toWei and Zhang (2003), stock returns volatility of high levered firms is higher than low levered firms, because high levered firms have high risk of bankruptcy.The results of Duffee(1995) are against it, which states that the stock price volatility of firms with low financial leverage is higher during shocks.

Some researchers find no relationship between stock price volatility and leverage. For example Hasanhodzic and Lo (2011) examines the stock prices volatility of 23 all equity financed (AE) firms and 41 debt financed (DF) firms from 1972 to 2008 in relation to stock prices fall (shock). The sample is taken from University of Chicago's Center for Research in Security Prices. The researchers conclude that stock price volatility is negatively related to the shock for both the leveraged and non-leveraged firms, arguing that leverage plays no role in stock price volatility.

RESEARCH METHODOLOGY

The aim of this study is to examine the effect of general election 2013 on stock prices of public listed firms at Karachi stock exchange. Event study methodology is widely utilized in finance to analyze stock prices response to specific events such as dividend announcements, mergers and acquisitions, stock splits and changes in policies(LIU, 2007). Event study methodology is based on efficient market hypothesis, which states that stock prices reflect all available information, and any change in stock prices must reflect new information(Fama, et al., 1969). The general election is an event; therefore,

for measuring its impact on stock prices, the researchers used event study methodology. For conducting event study, we follow the steps suggested byMackinlay (1997).

Event Defined:

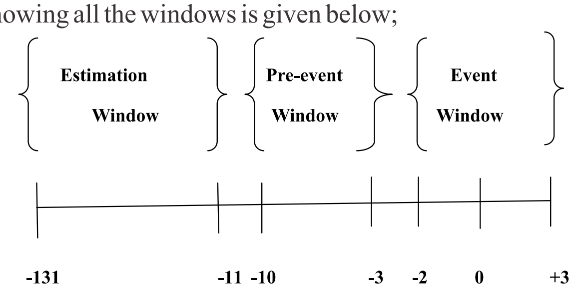
The researchers are intended to examine the impact of general election 2013 on the stock prices of Pakistani public firms; therefore, the event of interest for this study is the general election 2013 in Pakistan, which held on May 11,2013. Therefore,May 11 is the event day which becomes time zero, (t=0).

Event window is the time period in which stock prices of firms listed at Karachi stock exchange are intended to observe. As the event is the general election 2013, therefore event window is theoretically the polling day, but for analyzing the stock price reaction, it is expanded to ten days. The event window of this study starts at t= -2(two days before polling day) and ends at t= +3 (five days after the polling day). This event window is chosen because 2 days before elections, the election campaign completes and the voters normally have decided the party to which they want to elect. The election results are announced after one day but the complete information about all the seats takes about three days. The polling day is not included in the event because it was Saturday and the stock market remains closed on weekend.

The pre event window is defined as (-10, -3). This is the period of intense political campaign and media coverage. The candidates influence voters through advertising, claims and other different tools(LIU, 2007).

The estimation window of this study is set as (-131, -11), which is 120 days prior to the pre event window. The estimation window is set for the purpose of getting returns free from any election effect(Pantzalis, et al., 2000).

The time line showing all the windows is given below;



Measuring the impact of event on stock prices:

To know the impact of an event on stock prices, the abnormal returns during the event window are measured. Abnormal return is the difference between the expected return (in the absence of the event) and actual return which are obtained when the event occurs(Mackinlay, 1997).

To find out the impact of the event, size, profitability and leverage on the stock prices, regression model 1 below is used

$$SP = \beta 1 + \beta 2SZ + \beta 3ROA + \beta 4LV + \beta 5ET + \varepsilon \ldots\ldots\ldots\ldots (1)$$

Whereas, SZ measure size of the firm, ROA is profitability, LV is leverage and ET capture the impact of event on stock price. This model states that variation is share prices is function of the size, profitability, leverage and event. The co efficient of interest in model 1 is $\beta 5$, which measures the impact of the event.

Sample and Data:

The sample consists of 50 randomly selected public listed firms from Pakistan. Allthose listed firms are included in the sample for which the daily stock data is available. Daily data about the share prices is obtained from the Business Recorder. The data about the size leverage and profitability is obtained from annual reports of the companies.

RESULTS AND DISCUSSION

This study examines the effect of general election 2013 on stock prices of firms listed at Karachi stock exchange. For this purpose we first find out the abnormal returns during the event. The abnormal returns show that the event has an impact on share prices of public listed firms of Pakistan. We then used regression (least square method) model 1 to find out the significance of the event impact. This model is also utilized for finding out the impact of size, leverage and profitability on share prices.

Table 1: The Impact of General Election on Stock Price

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	65.27	66.81	0.97	0.3291
SZ	6.47^{-03}	17.58^{-02}	3.68	0.0003
LV	10.34^{-02}	33.01	31.34	0.0000
ROA	-18.22^{-04}	7.58^{-04}	-2.40	0.0167
ET	**-10.31^{-01}**	**46.88**	**-2.19**	**0.0283**
R-squared	0.70			
No. of Observations	499			
F-statistic	301.19			
Prob(F-statistic)	0.00			

The results obtained from the regression model 1 are reported in table 1. The coefficient of SZ is positive and statistically significant at the level of 1%. It means that large sized firms enjoy high stock prices during the event. The results of the study are inconsistent with those of Duffee, (1995) and KEIM, (1983). According to the findings of these studies, the stock prices of small size firms are more volatile during events. The impact of leverage on stock prices during the event is statistically significant, and its coefficient is also positive. It means that the stock prices of highly levered firms change more positively during the general election 2013. The results of the study are in line with that of Schwert, (1989) and Wei and Zhang, (2003). The results are inconsistent with Lang and Stulz, (1992), Duffee, (1995) and Hasanhodzic and Lo, (2011).

The profitability impact on stock prices during the general election 2013 is significant at the level of 1%. The stock prices of most profitable firms are less volatile than low profitable firms during the event. The negative coefficient indicates negative association between profitability and stock prices. It means low profitable firms

experience high share price volatility. The results of the study are consistent with the findings of Wei and Zhang, (2003). However our results are inconsistent with Hunjra et al., (2014), which argue that the returns of profitable firms are more volatile and positive.

Now we turn our attention toward our main variable of interest i-e the impact of event (ET) on share price. The results reported in table 1 shows that coefficient of ET is negative and statistically significant at the level of 5%, which shows that event captured by ET has negative impact on the share prices of the public listed firms of Pakistan. This means that the event (general election 2013) has negatively affected the stock prices of public firms.Liargovas and Liargovas(2010) analyzed the impact of political events on share prices of Greek banks, and found negative responsive to such events.Gul et al., (2013) also report that political events have negative impact on the stock prices. The results of the study are also consistent with the findings Tornero and Ortega, (2009).

However, the results are inconsistent with the findings reported by LIU(2007), which states that the stock prices of firms listed at the stock exchanges of five East Asian countriesexhibit positive returns during general elections. Pantzalis et al., (2000) examined the stock prices of 33 countries around political election and found positive abnormal returns. The results are also inconsistent with the findings ofMalik et al., 2009,Snowberg et al., (2007) and Bialkowski et al., 2008.

CONCLUSION

The study examines the impact of political event (general election 2013) on the stock prices of public listed firms of Pakistan. The impact of size, leverage and profitability during the event is also analyzed. The results reveal that the general election 2013 has negatively affected the stock prices. The results also reveals that the share prices of large sized firms are more volatile during the event. The leverage also has positive impact on the share prices during the event. While the share prices of more profitable firms show little volatility as compared to less profitable firms during the event.

The results of this study will enhance the understanding of managers and investors regarding the behavior of stock prices during political elections. The results of the study have also policy implications. In addition, the outcome of this study will benefit both the national and international investors, to understand the role of size, leverage and profitability during general election.

The theoretical significance of the study is manifold. First, it contributes to the field of corporate finance, by analyzing the stock price volatility (the relationship of stock prices to general elections) and provides evidence from the perspective of Pakistani public listed firms. Second, the study adds to the existing literature on the behavior of stock prices during general elections. Third, this is the first study of its kind, up to the best level of researchers'knowledge that has focused on the impact of single general election on stock prices. Finally, this study results will serve as food for thoughts for future researchers.

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