The impact of the Internet on earnings announcements

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Abstract

This study examines the impact of the Internet on earnings announcements, in an Australian context, with relation to (1) information content (2) post-earnings announcement drift (PEAD) and (3) information asymmetry. Our results for the pre-Internet (1996) and the post-Internet (2000) periods provide mixed evidence on the changes in the information content of earnings announcements. However, we detect a reduction in both the magnitude and duration of the post-earnings announcement drift in the post-Internet period for the positive unexpected earnings decile. The analysis on abnormal volume, spread and market depth do not show a significant change in information asymmetry between the pre- and post-Internet periods for preliminary final announcements.

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1. Introduction

The body of empirical studies investigating the relationship between earnings announcements and share prices has been both voluminous and diverse. Previous literature, beginning with the seminar paper by Ball and Brown (1968), has placed much emphasis on the
importance of earnings announcements due to its implications on the performance of a firm. The increased popularity of the Internet and online trading (introduced in 1997) has brought about a change in the investment environment. The influx of Internet websites providing financial content and investment-related services allows investors access to large volumes of timely, inexpensive information while simultaneously reducing trading costs. In view of the changes in the investment environment, share price reaction and trading around earnings announcements are likely to be different.

Several papers have recently examined the share price reaction to and information content of earnings announcements over time. Johnson and Schwartz (2000) provided evidence of a decrease in the profitability of the post-earnings announcement drift (PEAD). Others such as Landsman and Maydew (1999) and Kim and Kross (1999) have found an increase in information content of earnings announcements over time. These papers, among others, have found that various aspects of earnings announcements have been altered with the change in the economic environment. Several explanations have been provided for these changes, but one that has been widely discussed is the change in information dissemination brought about by the improvements in technology. The decrease in the cost of computing and communications has provided market participants access to vast amounts of information, possibly diminishing the importance of accounting information (Landsman and Maydew, 1999).

In addition to the possible improvements in information dissemination, which reduces information asymmetry, the Internet can affect investors’ reaction to earnings announcements in several other ways. Recent papers have explored how the Internet impacts the behaviour of investors (Barber and Odean, 1999; Choi et al., 2000). Others have examined the use of the Internet as an information dissemination tool (Dewally, 2000; Wysocki, 1998). The empirical studies to date provide a consensus view that the Internet has had an impact on investors.

This paper attempts to examine the impact that the introduction of the Internet has had on earnings announcements in Australia. Three related questions are asked: (1) Has the introduction of the Internet led to a decrease in the information content of earnings announcements? (2) Is there a reduction in the PEAD with the change in investment environment brought about by the Internet? (3) Is there an improvement in information asymmetry around an earnings announcement with the introduction of the Internet?

A motivating factor for this study is the concern that regulatory bodies such as the Australian Securities and Investment Commission (ASIC) have regarding the growth in online trading and the corresponding increase in securities trading by retail investors (ASIC, 2000). Many claim that the Internet can have an adverse effect on these investors by increasing the amount of noisy information that they receive. Earnings announcements provide an ideal scenario to examine the possible effects generated by the Internet because of their regular and periodic nature. Furthermore, investors’ reactions to earnings announcements have also been widely documented, and previous results provide a point of reference for comparisons.

This paper builds on a recent paper by Ahmed et al. (2003) that has examined how online trading affects investors’ reaction to earnings announcements. This study enhances their work by examining a wider aspect of earnings announcements, combining traditional capital market research methods with market microstructure research to investigate changes around
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