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The impact of non-financial reporting on stock markets in emerging economies

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Abstract

Stock prices are more and more driven by the investors' sentiment which, in turn, is sensitive to various non-financial events like macro-economic releases and social or environmental changes all over the world. In a globalized world, even the emerging and frontier economies such as Romania are following the main trend of the developed markets. The main concern of the last few years in the capital markets across the globe was the European Debt Crisis and for the purpose of this paper, we considered the most important news related to this subject as non-financial reporting. Therefore, major news and reports regarding this issue are seen by investors as the most important factors that are moving the markets. This paper analyses the impact of the relevant EU Debt Crisis news on the main European stock indexes using the price volatility. The results of the study showed, among others, that most of the stock markets reacted to news before it was actually released and from this point of view, the markets are tending towards the semi-strong form of efficiency that Eugene Fama was proposing in the *efficient market hypothesis.*

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Keywords:non- financial reporting; technical analysis, frontier market; emerging market; financial contagion,volatility indicators;

1. Introduction

The European Debt Crisis is the main focus of the investors in the last few years as many important countries are facing difficulties in paying their sovereign debts. Greece, Spain, Italy and Portugal are the European countries that are taking turns in the media headlines for more than three years. The professional

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investors are closely watching their bond auctions, their approach regarding austerity measures and, maybe the most important, the European Central Bank ECB decisions concerning various bailout plans or further economic stimulation measures. Previous research Dutescu, 2000, regarding how accounting information may influence investment decision on stock markets concluded that the level of understanding and application of accounting and financial information by the Romanian institutional investors is satisfactory. This conclusion may lead to the assumption that financial reporting may have a significant influence upon stock prices' movement on the Romanian capital market. Nevertheless, other research focused on the impact of financial reporting upon stock prices movement in case of some relevant Romanian investment companies traded on Bucharest Stock Exchange Spatacean, 2011, reflected a modest impact on volatility caused by financial reporting over the period 2006-2012. A possible explanation would refer to a significant proportion of individual investors who neglect an adequate study of financial reports, even though institutional investors may act reasonable on a fundamental basis. This finding may suggest that, under financial contagion circumstances, stock volatility is significantly caused by other factors, such non-financial reporting. Furthermore, we focused our research on some particular event studies that consisted in analysing stock prices movements on the announcement date and close to it of relevant public events. The purpose was to test the speed of stock prices adjustments, as the information reach to the public investors Todea, 2008. The main challenge was to determine whether the market proves effective at anticipating new information under the assumption that share prices progressively reacts as the market "guesses" become more confidently held Lumby, 1995.

2. Research methodology, hypothesis and data

In order to measure the impact of the EU crisis news on the capital markets across Europe, eight stock indexes from all the market categories have been selected: German DAX, French CAC, Spanish IBEX and Italian FTSEMIB for developed markets; Polish WIG and Czech PX for emerging markets; Romanian BET and Bulgarian SOFIX for frontier markets. The market classification was made using data from the most important research companies: FTSE, MSCI, S&P and Dow Jones. The research agencies made their market classification according to the fields of law, market regulations, manipulation and financial products. By *non-financial reporting event* we consider all the major macro-economic, legal, political and natural events that have the power to significantly influence the investors' sentiment that, in turn, is reflected in the stock market evolution. Unlike corporate financial reporting earnings, estimates, cash flows, growth indicators, financial ratios that is influencing a specific stock or, at most, another few connected companies, non-financial reporting is usually leading to changes in the most stocks in a certain country or even in the whole world. This paper will analyze the news that, according to Bloomberg[†] are top rated in the context of the EU debt crisis. There is a set of 124 news, starting from the 25th of February 2009 and ending on the 12th of September 2012. More than 40% of the news is related to ECB, while the other 60% mostly concerns meetings and declarations of the most important leaders in the European Union EU. The impact of news in a market is reflected in the price action of the studied index and the research methodology uses a volatility price indicator that shows price amplitude, expressed by its absolute value. A high price volatility shows the interest of the investors in trading that specific asset, whether they want to buy or to sell, as a result of the news interpretation. In determining the volatility, we used the concept of *true range,* developed by J. Welles Wilder in 1978:

[†] Most news are related to ECB statements like: *6/4/2009 - ECB launches first covered bonds programme; 4/7/2011 - ECB raises interest rates by 25 basis points*