



Credit Rating Announcements and Stock Returns: Evidence from the Banking Sector of Pakistan

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Abstract

This study examines the impact of credit rating announcement on stock returns of 22 banks rated by the Pakistan Credit Rating Agency and listed in Karachi Stock Exchange. Daily stock returns have been used, covering period from 2008 to 2014. The study uses event study methodology; a fifteen days event window has been created to examine the effects of credit rating announcement on Karachi Stock Exchange stock returns. The study finds that credit rating announcement has no significant impact on sample banks' abnormal stock returns. This study also documents the reaction of stock returns to the upgrade and downgrade announcement of credit rating. The study reveals that downgrade announcement show significant positive response, whereas the upgrade announcement provides insignificant negative response.

Keywords: Abnormal stock returns, Credit Rating Announcement, Event Study, Karachi Stock Exchange, Pakistan Credit Rating Agency, Upgrade and Downgrade Announcement

1. Introduction

One cannot overlook the significance and worthiness in the investment and capital market on the fiscal and financial improvement of any country; it is usually nicely reported in both equally educational and professional literature. Perhaps this success and accomplishment in professional trends and industrial revolution, which often had serious results for the social, financial, economic and cultural conditions in the entire world, is usually assigned to these kinds of markets. Since their own inception, the financial and fiscal markets have developed immensely. They have got enormous progress, and possess unimagined amounts of complexity. Nevertheless, the capital and financial markets remain not even close to perfect. Investment and capital markets have observed several cases of failure, from the monetary and financial hiccups involving 1850s that culminated within the great depression, on the compilation of financial and monetary downturn seen within past few years. The idea of free markets doesn't make it possible for just about any governmental input and involvement; nonetheless, the significance of financial markets on the world's economy and also the relevance of the losing of public wealth on their failing warrants deterring measures.

This importance is thoroughly discussed in literature as it will affect the economic as well as social fabric of a country. There are no two opinions over the matter that financial markets have developed immensely and become very complex. It is very difficult to understand the current scenario and use the available information to earn abnormal returns. One can argue that the capital markets are still far way from being perfect. Capital markets have witnessed several cases of failure as a consequence of some monetary and financial hiccups. These failures results in losing considerable wealth of the investors. One of many approaches used to prevent capital market failures is to expand the information degree of market participants along with introduction of laws that can ensure sleek functioning of financial markets. Consequently, various information intermediaries (for instance credit rating agencies) are permitted to operate in capital markets. This permission helps market participants and policymakers to regularly review the rules and ensure smooth performance of the markets.

Credit rating agencies have attained substantial print and electronic media coverage since the inception of financial meltdown. The credit rating agencies obtained criticism and denigration in the years following the financial hiccups like Enron and Lehman Brothers. Investors, regulators, legislators, and the business community raised the fingers and questions on the role of credit rating agencies in the market chaos. One example that strengthens the critique is that the credit rating agencies were conscientious for adding up to the housing bubble in the United States by giving the 'AAA' rating to multifarious, risky asset backed securities and along with the different types of derivatives. This is evidently a subject involving public curiosity and fascination, while credit ratings (or deficiency of correct ratings) might cause an enormous effect on stock returns and economic climate.

Credit ratings represent the probability of default on a continual basis. These ratings tend to be discrete and should never respond to just about any change in the market except if the change can impact the firm's capacity to pay back its debts in addition to interests. In efficient markets the stock prices should reflect all information. Therefore, the intriguing question is that whether all information pertinent to pricing is integrated in the stock price or not. The credit rating agencies make use of publically available information whenever they carry out the credit

ratings practice. Based on the efficient market hypothesis (Fama, 1970), share price reflect all available information meaning that when the credit rating of a firm is announced its effect comes in the firm's stock price. The literature addressing this subject matter is ambiguous and the empirical results are also contradictory. However, Hand, Holthausen, and Leftwich (1992) argue that announcements of credit rating communicate new information to the market.

The main objective of this study is to examine the effect of credit rating announcements on daily stock returns for banks indexed in Karachi Stock Exchange (KSE). This study has major contribution because Pakistani market is relatively new terrain for this type of research. After conducting this study, the findings of this study will be able to assist and contribute theoretical and in addition to practical both. This contribution to existing hypothesis is twofold. First, this kind of study is specifically a market study, to discover what effect credit rating proceedings have specifically on stock returns. Second, the Pakistani market is smaller in size as compared to United States market where the most of the prior studies has been carried out. So this study present out-of- small sample evidence by utilizing a similar study approach. The practical contribution and input of this study is twofold. First, this specific study will certainly bring about with abnormal returns for most of the major Pakistani banks. Abnormal return information is precious pertaining for the groups of investors interested in the Pakistani market. Two, by analyzing the impact of credit ratings on the Pakistani market fetch consciousness to the public of what effect credit ratings from Pakistan Credit Rating Agency (PACRA) have.

In sum, the EMH requires the inclusion of all publically available information to be incorporated in the stock prices, so that no one could outperform the market. This requires that whenever the information comes into the market, the stock market prices must recalibrate themselves. The banking sector is one of the most regulated sectors in the financial industry of Pakistan. This study investigates the effect of credit rating announcements on stock returns and also takes into account the effects of downgrade and upgrade rating announcements on the behavior of stock returns.

2. Review of Literature

Wide ranging investigation has been accomplished about the effect associated with share prices in order to modifications and changes with credit rating. The contemplate involving the majority of the investigation is about credit rating changes involving Standard & Poor's along with Moody's in the United States market. The repercussions of the reactions to downgrades and also in addition to upgrades associated with credit ratings tend to be diverse and assorted. Weinstein (1977) perused the behavior associated with corporate bond prices throughout the time period about the change announcement of a rating. The results contended and asserted that the market shouldn't contemplate that changes in bond-rating divulge new information. The results identified some evidence connected with price change throughout the time period by 7 to 18 months ahead of the announcement from the rating change. Nevertheless, this study located no evidence relating to price change in six months prior the announcement of any rating change. But this study also discovered little evidence throughout the course of the change or six months later on.

Wakeman(1998) observed statistically trivial price riposte utilizing monthly security returns and along with weekly bonds returns. Griffin and Sanvicente (1982) looked at the

fluctuation and reaction in common stock price to the credit rating announcements. They utilized an event window of merely 12 months and explore stock price adjustments in 11 months before and one month during rating change (reclassification) announcement. Their results for rating downgrades and upgrades are assorted. The results demonstrate pronounced cumulative abnormal returns (CARs) pertaining to downgrades for that 11 months prior to the event time period and also the month throughout the time of event period. Nonetheless, there were clearly no considerable results for upgrades of rating. Holthausen and Leftwich (1986) were being the first to uncover substantiation of which downgrades simply by Moody's ratings and along with Standard & Poor's are regarding negative but significant abnormal stock returns, though no response is available with regard to upgrades. They employed daily returns data within empirical investigation. They observed and identified negative but considerable excessive stock returns over the two-day event window, even though after eradication of observations those have synchronized issue of news. Stickel (1986) looks at the effect involving preferred stock rating adjustments on preferred stock returns and also discovers substantiation in step with price upshots for both equally upgrades and downgrades.

Hand, Holthausen and Leftwich (1992) came to the conclusion to United States market of which rating downgrades reveals new information to investors, whilst upgrades don't have any influence with the reason that they're already integrated with the prices. In line with Goh and Ederington (1993), don't assume all rating downgrades are awful news pertaining to shareholders. Specially, downgrades caused by adjustments in financial leverage specify budges of the wealth through bondholders to shareholders. After the prior study, Goh and Ederington (1999) hypothesized that reaction relate to downgrade hinges about the both implications for the level of surprise and firm's cash flows. Analysis present in which often downgrades sample aftermath to the 2-day event period in the negative (adverse) mean cumulative abnormal returns (CARs) connected with -1. 21%. The result when upgrades are usually declared result for the two-day (0 day, 1day) estimation window in positive and significant mean cumulative abnormal return associated with 0. 095%. This says of which downgrades are usually to a certain extent caused by preceding negative public information in addition to upgrades glimpse simply because of public information.

Kliger and Sarig (2000) checked whether or not bond ratings communicate price-pertinent information simply by examining security price tendencies. They make use of refinements connected with Moody's rating system and the polished information did not consist of virtually any fundamental and basic change from the issuer's risk. The fallouts of their study also demonstrate that rating information doesn't have encroached on the firm's value. In addition, the rating changes also triggered and incorporate new information to the market which is valuable. Moreover, their results also provide evidence when rating system of Moody's released any new information then the both bonds and stocks prices are react and price adjustments especially for bonds are also provided. Dichev and Piotroski (2001) applied a wide-ranging sample involving ratings changes in their study of exactly how Moody's ratings influence long-run stock returns. They unearth absolutely no reliable and consistent abnormal returns after rating upgrades. Even so, they locate negative significant abnormal returns after downgrades announcement with the enormity of -10% to -14% at (one year) 12 months horizon. Further investigation demonstrates that this specific underperformance is specially marked and expresses with regard to small and low-credit-quality companies. Jorion and Zhang (2007) assessed the announcement effects of rating reclassifications on stock returns. They analyze that small sample

of downgraded firms with an average CAR regarding -4.43%, that is statistically highly substantial but the price change for upgraded companies is only CAR +0.31% which is closer to zero. They also examine that downgrades are heavily impact the price changes than upgrades. Similar to Dichevand Piotroski (2001), they notice that scales of magnitudes of abnormal returns are even greater for low credit quality companies.

All the studies discussed above are with reference to the United States only. The account of studies that are conducted in other countries is as follows:

Matolcsy and Lianto (1995) examined the effect and reaction of rating reviews and changes and also provide the information content evidence of credit rating reclassification in Australian Stock Market .They utilize rating changes and modifications issued by the Standard & Poor's-Australian Ratings coming from the period of 1982 to 1991. The results indicate that rating downgrades accommodate and incorporate substantial cumulative average abnormal returns (CAARs). Last words made were being in accordance with earlier studies on United States markets in which a downgrade rating introduced new information to the market whilst an upgrade rating did not. The abstraction of Barron, Clare and Thomas (1997) focused on the upshots associated with credit rating reclassifications (adjustments) on the United Kingdom market. They assess the impact intended for UK both long and also short-term debt making the use of daily data coming from the period of 1984 to 1992. They identified substantial excessive stock returns related to bond rating downgrades as well as positive and significant CreditWatch pronouncements. Changes in credit rating having an influence on short-term financial debt have zero substantial impact, that's the situation pertaining to new long-term financial debt credit ratings. The results of this study also signify that gains to firms of possessing the credit rating do not available in the form of substantial reductions in the firms cost of equity capital and also find that new rating insignificantly effect the systematic risk or stock returns volatility.

Elayan, Hsu and Meyer (2003) perused credit rating changes pronouncements for New Zealand companies. This study is different from other large markets studies because it captures the small market reaction to credit rating pronouncements. Contrary to majority of the United States studies where only negative pronouncements trigger statistically substantial market reactions, but positive announcements connotations crank out the substantial excess returns for NZ companies. In conclusion, the fallouts of this study also demonstrate that rating actions significantly affect the share prices and CAARs for all upgrade and downgrade rating actions are found significant. They argued that these positive and negative market fluctuations and reactions would propose that credit ratings furnish useful data to the market participants. Linciano (2004) analyzed common stock prices to credit rating actions pertaining to Italian listed companies released by Moody's rating, Fitch and along with Standard & Poor's for the data set of 299 credit rating actions from the period of 1991 to 2003. Rating actions are classified as outlined by their direction, anticipation, the particular presence involving concurrent news and reports, the reason why of rating action and the sector of the obligor (rated entities). Their final results demonstrate of which, generally, share price effects to credit rating change pronouncements are generally relatively mild or perhaps insignificant. The market concedes the substantial abnormal (excessive) returns for actual downgrade ratings. In 3 day (-1, 0, +1) estimation window, negative rating exhibits cumulative abnormal return (CAR) equals to -1.34%. With despite prior research they indicate that expected rating behavior have a larger effect on market prices when compared with unforeseen ones. Nevertheless the sample possesses a small volume of

unpredicted events and hence it is not a robust conclusion. In addition the results indicate that negative excessive returns are generally substantial lower for financial sector as compared to industrial sector.

Abad-Romero and Robles-Fernandez (2006) perused credit rating changes pronouncements for Spanish market and found the contradictory results as compared to previous studies. This study also fabricate the evidence that significant negative returns for rating upgrades but insignificant returns for rating downgrades. Poon and Chan (2008) carried out a study on the information content of ratings in China using cross-sectional regression. The investigation suggested the asymmetric certification effect and signaling effect for initial credit rating and downgrade rating announcements respectively. The results of the study support the asymmetric certification effect hypothesis and also signify the negative signaling effects for downgrade ratings. The findings of this study also elevated several qualitative arguments that credit ratings have not information content in China. Hun Han et al. (2009) looked at stock market responses to corporate rating adjustments and changes of Moody's rating and Standard & Poor's in emerging market countries which are included in MSCI Emerging Market Index. The results of this study connote that stock market significantly respond to American depository receipts (ADR) markets. The study also locates that mean CARs for rating downgrades and rating upgrades are statistically significant in ADR markets. In ADR markets, firms have higher market capitalization and lower debt ratios than firms in local markets. This study also report that stock markets significantly react not only to rating upgrades but also to rating downgrades in ADR markets. Furthermore, the less transparent financial disclosures in emerging markets are main reason for cropping up the rating downgrades and upgrades CARs.

3. Theoretical Framework and Hypothesis Development

3.1. Efficient Market and the Information Content Hypothesis of Credit Rating Change Announcements

Almost all the research and investigation about credit ratings focus on no matter whether credit ratings changes (upgrades and downgrades) consist of pricing pertinent information. The credit rating change can provide the market a precursor that issuer's creditworthiness is transformed and changed. In general, a significant reaction arises to share prices as a rejoinder to (new) news. The particular question arises that if the market feels that any change in credit rating encloses new information. Under the heading of information content hypothesis, it really is predicted that share price give respond to the change in credit rating on the event date.

Eugene Fama (1970) depicted an efficient capital market in view of the fact that "a market through which prices generally fully mirror and reflect all available information at any point". He try to alternating particular efficient market hypothesis that claims that security prices might adapt relative to three information splits, namely weak, semi-strong and along with strong form of the market efficiency. He also tests and signifies that capital markets are fall under the weak form of capital market efficiency and capital markets are weak form efficient, within one cannot really be ready to generate excess returns depending and determined on historical prices.

Fama ,furthermore, detects and locates support associated with semi-strong form of market efficiency, meaning that prices tend to be assumed to fully echo most obviously widely

publically offered and available information. In capital market hypothesis, strong-form associated with market efficiency symbolizes that all available information, both publically and privately (non-publically) is mirrored in the prices of security. It is, as outlined by Eugene Fama (1970), an extremely stringent assumption, and also the strong-form model is most suitable seen and viewed as a standard (benchmark) towards which in turn deviations via market efficiency might be analyzed.

The credit rating agencies have got, with the credit ratings process and procedure, having access to non-public personal and private information. This type of information is, together with all other obtainable options for information, employed by the credit rating agencies so as to type a viewpoint concerning the obligor's creditworthiness and credit reliability. The verity that credit rating agencies have way in to insider's details (information) crafts asymmetry between market and the credit rating agencies. If share prices respond to the announcements of the credit rating that implies that the credit rating agencies provide and communicate new information to the financial markets. Alternatively, if share prices will not retort to changes inside credit ratings, it indicates that financial market especially stock market has ingested and absorbed this new information which is discounted and reduced into the share prices. This kind of provokes the analysis of the information content relating credit rating change announcements.

Systematically and methodically non-zero abnormal returns of stock carrying out a change within credit rating usually are sporadic with market efficacy. The research and study on the impact connected with credit rating change (upgrade and downgrade) announcements on stock returns might hence possibly be often considered as a test out upon strong-form of market efficiency. Extensive investigation and analysis has become carried out on the information content regarding credit rating announcements. In line with Holthausen and Leftwich (1986), first paperwork simply by Weinstein (1977); Pinches and Singleton (1978) and also Wakeman (1998) uncover simply no significant effect regarding credit ratings announcements about stock returns. In a row investigation by simply Griffin and Sanvicente (1982); Wansley and Clauretje (1985); Gropp and Richards (2001); and Creighton, Gowe, and Richards (2007) nonetheless, spawned evidence of abnormal behavior of share price after the announcements of credit rating. The lack of substantial results with earlier analysis may be simply because which they bottom the research and investigation on weekly or monthly data. The utilization of daily data is very constructive to be able to isolate and segregate the effect of the credit rating announcement (change) on stock prices (Hand, Holthausen, &Leftwich, 1992).

Hand, Holthausen, and Leftwich (1992) locate the same evidence as Holthausen and Leftwich (1986) regarding downgrades associated with both Moody's and Standard and Poor's and also find negative and unfavorable abnormal stock returns. That supports the debate which the rating agencies supply details towards the investment capital markets by having a downgrade or perhaps which downgrades inflict higher costs toward the firms, correctly escalating its marginal cost connected with debt. That they come across very little substantiation to get abnormal returns associated with upgrades. Not too long ago, Hand, Holthausen, and Leftwich (1992) find out that share price upshots linked with announcements of changes (upgrade and downgrade) of credit rating by simply Standard and Poor's and Moody's ratings. They locate a significant adverse connection among rating downgrade announcements and share returns. On the other hand, the domino effects are not noteworthy regarding rating upgrade announcements.

The inconsistent empirical ends up with past studies are usually as a result of failing to be able to control intended for anticipation (Hsueh & Liu, 1992).

To put it differently, the content connected with credit ratings must not be cared for seeing that homogenous irrespective of company as well as time period. Somewhat, one should look at the accessibility of information in the market out there before rating announcement. Company-specific information will be far more unhesitatingly available for many companies than pertaining to others because of different coverage through the media, economic and financial experts and so forth, along with investors may be expecting the particular rating change on companies they've already more information with regards to. For that reason, the information content connected with credit rating is actually far more considerable pertaining to firms where information is actually fairly constrained. For that reason, the reaction of share price to rating announcements is actually contingent around the market's concern and expectation. Hsueh and Liu (1992) also demonstrate that rating change impact is more evident during the periods connected with high market skepticism. Hereafter, the pertinent question to solicit is whether or not this information is pricing pertinent and also beneficial. This particular question has been susceptible to study, with virtually no homogeneous response. Kliger and Sarig (2000) identified a method to segregate the price reactions to be able to rating changes of which exclusively mirrored rating information. Their bottom line is that credit rating information is definitely useful and that both bond yields and stock prices modified and adjusted to the brand new rating information.

H₁₀: Credit ratings announcement have significant effect on stock returns.

H_{1A}: Credit ratings announcement have no significant effect on stock returns.

3.2. The Wealth Redistribution Hypothesis

Even though nearly all researches look for an adverse rapport between share prices and bond rating downgrades. Holthausen and Leftwich (1986) dispute of which downgrades are certainly not important detrimental to shareholders. Additionally, Berk and DeMarzo, (2007) demonstrated that if the downgrade arises for the reason that company is usually dealing with more debt, perhaps it will move wealth through bondholders to shareholders, often known as asset substitution or even the wealth redistribution hypothesis.

Wansley and Clauretie (1985); Holthausen and Leftwich (1986); and along with Goh and Ederington (1993) discovered substantial returns before announcements, showing some anticipation and expectancy. For the reason that credit rating agencies post a quick elucidation for their proclamation of credit rating, Goh and Ederington (1993) hypothesize that the market response will likely be contingent with this motive. They claim that one could not anticipate to find a significant negative stock impulse for all downgrades, due to the fact a good predicted transfer connected with wealth by bondholders to stockholders needs to be very good news intended for stockholders. Therefore, any credit rating downgrade can call for a positive share value impulse.

As stated, most studies get a significant negative association concerning rating downgrade announcements as well as stock returns. Nevertheless, the results are certainly not significant regarding rating upgrading announcements. That is a baffling result, Hsueh and Liu

(1992) seeing that there is absolutely no some sort of priori reasoning why merely downgrades need to have an effect upon share prices. This implication associated with Merton's idea is usually associated with theoretical in addition to functional and practical attention. It demonstrates the purpose driving a change in credit rating is usually associated with both equally statistical and economic attention, and also it provides a reason why downgrades are not necessarily harmful to stockholders. Additionally, it may assist reveal why prior studies find thumbs down substantial upgrading reaction to equity. Goh and Ederington (1993) probes whether the motivation driving a firm-specific or market specific adjustment in credit rating is pertinent to share price reaction. They will do this conjecture of which previous studies tests might have been unsuccessful to discover a noteworthy relationship between credit rating upgrades and also stock returns since they fail to identify and acknowledge the rationale behind this modify in credit rating. Much more particularly, that they claim which firm-specific information has to be decomposed directly into upgrades or downgrades that are caused by (i) a noticeable difference (deterioration) inside the firm's financial prospective and (ii) the reduce or increase in firm's leverage (Goh&Ederington, 1993). This former explanation should have a positive impact on this share price, while second one can have the contrary effect. The two of these actual causes have got, offsetting results, which could describe insignificant equity backlash to upgrades. They know that, not surprisingly through earlier research, the market acts in a wrong way to be able to downgrade announcements. On top of that, they know that these types of downgrades are likely to be according to projections in the firm's future financial potential prospects and are therefore likely to include substantial information. To the contrary, announcements connected with downgrades relevant to improved levels of debt (e.g because of leveraged buyouts and debt-financed growth etc) tend to be modest and insignificant, recommending that these downgrades tend to be either anticipated from the current market as well as have fewer fascination to equityholders (Goh&Ederington, 1993).They can't locate almost any substantial relationship in between rating upgrades and also stock returns after decomposition while using underlying rationale, i.e. financial and fiscal prospects or even leverage. The key insight, on the other hand, is usually which rating alterations cannot be cared for as homogeneous and along with the explanation guiding the particular adjust with credit rating has to be regarded as.

Kliger and Sarig (2000), in contrast, provide evidence for asset-substitution hypothesis. Many of them realize that investors mislay while risk will be revised downhill i.e. rating upgrade, whilst bondholders reap the benefits of lessened risk assessments. In addition, meant volatility produced by the prices of options about the share decline using announcements of superior to anticipated ratings. The rating information is pertinent to the value of debt as well as equity respectively yet usually do not discover that it affects the combined firm's value (Kliger&Sarig, 2000). It indicates that a change within credit rating only way to transfer the wealth linking equity holders and bondholders. After scheming for anticipation, Hsueh and Liu (1992) uncover the significant equity price reaction to credit rating upgrades. Companies which shareholders possess a lesser amount of information before the announcement apply having a positive reaction on stock price from credit rating upgrade announcements.

The redistribution theory is actually regarding interest pertaining to credit rating announcements since it challenges the greater intuitive and perceptive elucidation concerning the affiliation in between credit rating downgrades and in addition to negative stock returns. It provides a new, theoretical and sound reason why downgrades might in fact trigger a positive

reaction to share price. Even so, regardless of its theoretical rationalization, the majority of empirical research seems to concur that the market behaves significantly but negatively and adversely to downgrade announcements (Holthausen&Leftwich, (1986); Hand, Holthausen, &Leftwich, (1992); Goh&Ederington, (1993); Norden& Weber, (2004); Linciano, (2004)). Credit rating upgrades, in contrast, are more disputable and also debatable. Kliger and Sarig (2000) stumble on the evidence going for wealth redistribution hypothesis of which shareholders shed when risk is adjusted downhill. But in contrast, Hsueh and Liu (1992) uncover that positive equity price reaction are associated with credit rating upgrades.

Hypothesis 20: Downgrades Announcement of Credit rating has a positive effect on stock returns.

Hypothesis 2A: Downgrades Announcement of Credit rating has negative effect on stock returns.

Hypothesis 30: Upgrades Announcement of Credit rating has a positive effect on stock returns.

Hypothesis 3A: Upgrades Announcement of Credit rating has negative effect on stock returns.

4. Data And Methodology

Data Description

The study will be based on assorted dataset. The entire sample having credit rating pronouncements is extracted from (Pakistan Credit Rating Agency) PACRA data source. Because investigation only takes into account the effect connected with rating pronouncements, credit ratings which are withdraw by the rating agency, are ruled out from the entire sample. The dataset include pronouncements of rating downgrades and rating upgrades. Adjustments with long term entity credit rating are utilized due to the fact most of these rating reviews comprise an agencies' view of a firm's potential for timely to meet the debt or financial commitments.

Credit rating actions are generally bought out a sample amount of 7 years, between the periods of 2008 to 2014 and comprise of 22 banks which are listed in KSE. The dataset will comprises of total 154 credit ratings announcements. As touchstone the KSE index is employed to calculate normal returns for the estimation time period. KSE Index daily adjusted prices and daily closing stock prices are extracted from KSE data repository and are also tweaked for credit rating pronouncements.

Methodology

Theoretically share prices should echo all public recognized information with reference to the firm's future. That's why, in perfectly efficient market, share prices should adapt and adjust quickly while fresh new information extends to the market. It is, nonetheless, not absolutely the way it is. Occasionally information is released before the public pronouncement

by the firm, and quite often it could take for the markets to effusive decipher the news. To gauge how a share price react in order to brand new information employ the event study. Fama (1991) contended that event studies are substantially used and also play a crucial and central role in corporate finance investigation and also the clearest evidence upon market-efficiency derives from event studies.

In this study, the time window is directly split into two parts. First, the estimation window or control period, this estimation time period needs to be prolonged enough to provide an excellent demonstration of the normal return and so confer an excellent prophecy of the expected return . Avoid too long estimation time period because this will make model parameters imbalanced. The control period will be selected depending on past studies findings but also greatly dependent upon how data in this particular study seems. The range of estimation window in this study is 60 days.

The second part of the time window is event window which is based on the number of trading days before and after the event date. The event date is a period of time at which credit ratings are announced and when market first time apprehends and captures the new information. The event window in this study consists of 15 (-7, 0, +7) trading days. After choosing the time window, the next step is to calculate the abnormal return (AR).Before getting the abnormal return, used the economic model CAPM for the estimation of expected return (ER). AAR and CAAR approaches are used in this study.

1. Abnormal Return

The abnormal return exhibits the reaction of one specific event with in particular point in time. The daily abnormal returns are calculated as difference between actual returns and expected return for an individual security.

$$AR_t = R_t - E(R_t)$$

Where

AR_t = abnormal return on time t ,
 R_t = actual return on time t , and
 $E(R_t)$ = expected return on time t

For abnormal return, actual return (R_t) is calculated as:

$$R_t = \ln\left(\frac{P_t}{P_{t-1}}\right)$$

Where

R_t = actual return on time t ,
 P_t = closing price on time t ,
 P_{t-1} = closing price the day before day t

For CAPM, market return is calculated as:

$$R_{m,t} = \ln \left(\frac{P_{m,t}}{P_{m,t-1}} \right)$$

Where

- $R_{m,t}$ = market return time t ,
- $P_{m,t}$ = closing price of market on time t ,
- $P_{m,t-1}$ = closing price of market the day before day t

Before getting the abnormal return, used the economic model CAPM for the estimation of expected return $E(R_t)$. Because MacKinlay (1997) argued that economic model CAPM make more precise expected returns because assumptions of CAPM based on economic factors. So the natural choice for this study is economic model CAPM.

$$E(R_t) = R_{ft} + \beta(R_{m,t} - R_{ft})$$

Where

- $E(R_t)$ = expected return of stock i on time t ,
- R_{ft} = risk free rate,
- β = sensitivity of stock to market return,
- $R_{m,t} - R_{ft}$ = market risk premium

2. Average Abnormal Returns (AAR)

To look the effect of events on stock returns of the company with in the event window, average abnormal return is calculated as follows:

$$AAR_t = \sum_{i=1}^N AR_{i,t}$$

Where

- AAR_t = average abnormal return of stock i on time t ,
- $AR_{i,t}$ = abnormal return of bank i on time t ,
- N = number of events

3. Cumulative Abnormal Return

The cumulative abnormal return (CAR) demonstrates the magnitude and size of effect of one particular event which contributes within a total time period. The cumulative abnormal return is sum of all abnormal returns on time t . The cumulative abnormal return is calculated as:

$$CAR_t = \sum_{i=1}^N AR_{i,t}$$

Where

- CAR_t = cumulative abnormal return on time t
- $AR_{i,t}$ = abnormal return of company i on time t

4. Cumulative Average Abnormal Return

The cumulative average abnormal return (CAAR) demonstrates the collective effect of all events of all securities throughout the whole event period. The cumulative average abnormal return is sum of all average abnormal returns on time t . The cumulative average abnormal return is calculated as:

$$CAAR_t = \sum_{i=1}^N AAR_{i,t}$$

Where

CAAR t = cumulative average abnormal return on time t

AAR $_{i,t}$ = average abnormal return of stock i on time t ,

The t-statistics is employed to test whether the AARs and CAARs are significantly different from zero or not.

$$t - stat(AAR) = \frac{AR_t}{\frac{\sigma(AR_{i,t})}{\sqrt{N}}}$$

$$t - stat(CAAR) = \frac{CAR_t}{\frac{\sigma(CAR_{t,t})}{\sqrt{N}}}$$

To evaluate the connotation of results, t-values are also weighed against the table values at 1%, 2%, and 5% criterion or significance level.

5. Empirical Results and Discussion

This specific section exhibits the empirical analysis and investigation carried out within the data. To evaluate the impact of credit rating announcements on stock returns, a sample consisting of fifteen banks listed at Karachi Stock Exchange is used. The following table shows the AAR and t-statistics for respective banks.

Table 1 (a)
AAR and t-statistics for Banks before and after Credit Rating Announcements

Days	Allied Bank		Askari Bank		Bank Alfalah		Bank Al Habib		Bank Islami Pakistan	
	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR
-7	-0.0016	-0.0734	-0.0002	-0.0085	0.0049	0.2194	0.0105	0.3685	-0.0058	-0.1669
-6	-0.0051	-0.2355	-0.0061	-0.2366	0.0047	0.2126	-0.0025	-0.0877	-0.0035	-0.1018
-5	-0.0077	-0.3539	-0.0078	-0.3009	-0.0058	-0.2636	0.0016	0.0566	-0.0034	-0.0991
-4	0.0144	0.6589	-0.0018	-0.069	-0.0034	-0.1533	0.0005	0.0165	-0.0056	-0.1604
-3	0.0051	0.2346	-0.0108	-0.4166	0.0047	0.2139	-0.0018	-0.0648	-0.0071	-0.2049

-2	0.0047	0.215	-0.0114	-0.4418	-0.0030	-0.1377	-0.0069	-0.2435	-0.0094	-0.2699
-1	-0.0029	-0.1324	-0.0028	-0.1100	-0.0150	-0.6760	-0.0101	-0.3565	0.0023	0.0677
0	-0.0047	-0.2136	-0.0087	-0.3374	0.0018	0.0827	0.0113	0.3985	0.0032	0.0935
1	-0.0061	-0.2791	-0.0001	-0.0047	0.0022	0.1014	-0.0123	-0.4323	-0.0080	-0.2296
2	0.0002	0.0113	0.0014	0.0535	-0.0018	-0.0822	-0.0016	-0.0570	0.0070	0.2017
3	-0.0015	-0.0684	-0.0079	-0.3047	0.0056	0.2514	-0.0008	-0.0282	0.0031	0.0886
4	0.0001	0.0026	-0.0014	-0.0552	-0.0025	-0.1109	-0.0030	-0.1048	0.0009	0.0272
5	0.0049	0.2224	0.0004	0.0150	-0.0019	-0.0874	0.0086	0.3030	-0.0046	-0.1339
6	0.0080	0.3672	-0.0005	-0.0187	0.0080	0.3615	0.0039	0.1380	-0.0058	-0.1682
7	-0.0006	-0.0257	-0.0105	-0.4047	0.0122	0.5516	-0.0020	-0.0696	-0.0079	-0.2283

Note: ***, **, * indicate 1%, 5% and 10% level of significance

Table 1(b)
AAR and t-statistics for Banks before and after Credit Rating Announcements

Days	Bank of Khyber		Bank of Punjab		Faysal Bank		Habib Metropolitan		JS Bank	
	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR
-7	-0.0033	-0.1043	0.014	0.4136	0.0136	0.5428	0.0023	0.1019	-0.0049	-0.1288
-6	0.0002	0.0078	-0.0145	-0.4276	0.0014	0.0539	0.0042	0.1807	0.0159	0.4180
-5	0.0178	0.5583	-0.0075	-0.2212	0.0134	0.5344	0.0011	0.0499	-0.0028	-0.0739
-4	-0.0443	-1.3892	-0.0159	-0.4699	0.0023	0.0906	-0.0047	-0.2041	0.0005	0.0128
-3	-0.0138	-0.4309	-0.0166	-0.4912	0.0099	0.3965	0.0079	0.3421	-0.0119	-0.3125
-2	0.0495	1.5523	-0.0108	-0.3186	0.0226	0.8996	-0.0001	-0.0030	0.0006	0.0150
-1	0.0107	0.3346	-0.0065	-0.1916	0.0044	0.1748	0.0087	0.3787	0.0007	0.0195
0	0.0117	0.3652	-0.0076	-0.2249	0.0122	0.4864	-0.0026	-0.1115	-0.0197	-0.5168
1	0.0007	0.0230	-0.0155	-0.4575	0.0197	0.7862	-0.0069	-0.301	-0.0105	-0.2766
2	0.0166	0.5203	0.0007	0.0199	-0.0021	-0.0831	-0.0046	-0.2005	-0.0223	-0.5861
3	-0.0027	-0.0858	-0.0048	-0.1429	0.0186	0.7424	-0.0017	-0.0745	0.0056	0.1476
4	-0.0028	-0.089	-0.0082	-0.2431	0.0032	0.1270	0.0040	0.1731	0.0007	0.0177
5	-0.0161	-0.5057	-0.0031	-0.0909	0.0126	0.5004	-0.0068	-0.2935	-0.0023	-0.0593
6	-0.0037	-0.1155	-0.0186	-0.5496	0.0068	0.2726	0.0005	0.0229	0.0059	0.1548
7	0.0083	0.2607	-0.0191	-0.5647	0.0140	0.5572	-0.0031	-0.1332	-0.0082	-0.2157

Note: ***, **, * indicate 1%, 5% and 10% level of significance

Table 1(c)
AAR and t-statistics for Banks before and after Credit Rating Announcements

Days	KASB Bank		MCB		NIB Bank		Standard Charter		Soneri Bank	
	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR

-7	0.0819	1.7424*	-0.0019	-0.1079	0.0066	0.1905	-0.0039	-0.1455	0.0008	0.0305
-6	0.0467	0.9931	0.0088	0.5019	-0.0037	-0.1062	0.0161	0.5977	-0.0161	-0.5848
-5	0.0779	1.6577*	0.0097	0.5569	-0.0126	-0.3613	-0.0035	-0.1300	-0.0008	-0.0279
-4	0.0521	1.1090	0.0028	0.1601	-0.0112	-0.3218	-0.0175	-0.6512	0.0013	0.0460
-3	0.1306	2.7778***	0.0035	0.2001	-0.0153	-0.439	-0.0145	-0.5399	-0.0062	-0.2242
-2	0.0702	1.4934	0.0059	0.3375	-0.0098	-0.2809	-0.0077	-0.2865	0.0018	0.0660
-1	0.1181	2.5116**	-0.0028	-0.1595	0.0031	0.0899	0.0074	0.2754	-0.0043	-0.1553
0	0.0665	1.4151	0.0022	0.1271	-0.0031	-0.0880	0.0109	0.4054	0.0125	0.4542
1	0.0479	1.0178	0.0017	0.0964	0.0014	0.0403	0.0120	0.4473	-0.0045	-0.1645
2	0.0524	1.1149	-0.0048	-0.2736	-0.0098	-0.2806	-0.0131	-0.4864	0.0107	0.3881
3	0.0506	1.0770	0.0026	0.1471	-0.0097	-0.2798	-0.0049	-0.1806	-0.0145	-0.5273
4	0.0383	0.8154	-0.0009	-0.0503	-0.0020	-0.0561	-0.018	-0.6713	0.0109	0.3942
5	0.0777	1.6527*	0.0031	0.1754	0.0049	0.1411	-0.0053	-0.1982	-0.0032	-0.1181
6	0.0579	1.2306	-0.0039	-0.2236	-0.0034	-0.0985	-0.0068	-0.2514	-0.0024	-0.0861
7	0.0573	1.2181	-0.0008	-0.0451	0.0020	0.0587	0.0018	0.0652	0.0024	0.0873

Note: ***, **, * indicate 1%, 5% and 10% level of significance

Table 1 (d)
AAR and t-statistics for Banks before and after Credit Rating Announcements

Days	Al-Baraka Bank		First Women Bank		NBP		SME Bank		Escorts Investment Bank	
	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR	AAR	t- Stat AAR
-7	-0.0016	-0.0724	-0.0002	-0.0075	0.0039	0.2185	0.0105	0.3696	-0.0059	-0.1669
-6	-0.0051	-0.2455	-0.0061	-0.2376	0.0027	0.2127	-0.0025	-0.0887	-0.0045	-0.1028
-5	-0.0077	-0.3549	-0.0078	-0.3019	-0.0059	-0.2648	0.0016	0.0576	-0.0024	-0.0994
-4	0.0133	0.6599	-0.0018	-0.0600	-0.0033	-0.1532	0.0005	0.0166	-0.0057	-0.1602
-3	0.0053	0.2347	-0.0108	-0.4174	0.0049	0.2149	-0.0018	-0.0649	-0.0074	-0.2039
-2	0.0048	0.2250	-0.0114	-0.4421	-0.0040	-0.1367	-0.0069	-0.2445	-0.0092	-0.2600
-1	-0.0039	-0.1334	-0.0028	-0.1100	-0.0150	-0.6770	-0.0101	-0.3576	0.0024	0.0678
0	-0.0046	-0.2146	-0.0087	-0.3383	0.0028	0.0817	0.0113	0.3975	0.0035	0.0935
1	-0.0072	-0.2792	-0.0001	-0.0047	0.0021	0.1004	-0.0123	-0.4333	-0.0082	-0.2298
2	0.0012	0.0133	0.0014	0.0545	-0.0016	-0.0842	-0.0016	-0.0571	0.0071	0.2027
3	-0.0025	-0.0685	-0.0079	-0.3028	0.0058	0.2534	-0.0008	-0.0284	0.0033	0.0886
4	0.0001	0.0036	-0.0014	-0.0554	-0.0025	-0.1107	-0.0030	-0.1047	0.0009	0.0274
5	0.0039	0.2224	0.0004	0.0105	-0.0029	-0.0865	0.0086	0.3031	-0.0047	-0.1339
6	0.0090	0.3682	-0.0005	-0.0197	0.0080	0.3715	0.0039	0.1383	-0.0056	-0.1684
7	-0.0016	-0.0256	-0.0105	-0.4038	0.0124	0.5527	-0.0020	-0.0697	-0.0079	-0.2273

Note: ***, **, * indicate 1%, 5% and 10% level of significance

Table 1 (e)
AAR and t-statistics for Banks before and after Credit Rating Announcements

Days	IGI Investment Bank		Tameer Microfinance Bank	
	AAR	t- Stat AAR	AAR	t- Stat AAR
-7	-0.0017	-0.0745	-0.0002	-0.0085
-6	-0.0053	-0.2255	-0.0063	-0.2367
-5	-0.0076	-0.3549	-0.0077	-0.3019
-4	0.0143	0.6598	-0.0018	-0.0691
-3	0.0052	0.2347	-0.0118	-0.4165
-2	0.0048	0.2151	-0.0113	-0.4419
-1	-0.0039	-0.1334	-0.0028	-0.1111
0	-0.0048	-0.2126	-0.0085	-0.3372
1	-0.0063	-0.2794	-0.0001	-0.0057
2	0.0003	0.0123	0.0014	0.0545
3	-0.0015	-0.0693	-0.0079	-0.3037
4	0.0001	0.0036	-0.0014	-0.0554
5	0.0049	0.2244	0.0004	0.0150
6	0.0080	0.3673	-0.0005	-0.0189
7	-0.0007	-0.0256	-0.0105	-0.4046

Note: ***, **, * indicate 1%, 5% and 10% level of significance

From the above results it can be concluded there is no significant effect on stock returns before and after the credit rating announcement of all banks. This result can also certainly imply that some sort of credit rating announcement doesn't have informational value.

Table 2
Average Abnormal Returns (AAR) and Cumulative Average Abnormal Returns (CAAR) and t-statistics for Rating Upgrades

Days	AAR	t- Stat AAR	CAAR	t-stat CAAR
-7	0.0259	0.7331	0.0259	0.7331
-6	-0.0020	-0.0554	0.0240	0.6777
-5	-0.0102	-0.2872	0.0138	0.3905
-4	-0.0005	-0.0128	0.0133	0.3777
-3	-0.0099	-0.2804	0.0034	0.0973
-2	0.0070	0.1978	0.0104	0.2951
-1	-0.0004	-0.0115	0.0100	0.2836
0	-0.0001	-0.0027	0.0099	0.2810
1	-0.0103	-0.2905	-0.0003	-0.0095
2	-0.0081	-0.2292	-0.0084	-0.2388

3	-0.0013	-0.0364	-0.0097	-0.2752
4	-0.0062	-0.1745	-0.0159	-0.4496
5	-0.0037	-0.1051	-0.0196	-0.5548
6	-0.0027	-0.0764	-0.0223	-0.6312
7	0.0016	0.0445	-0.0207	-0.5867

Note: ***, **, * indicate 1%, 5% and 10% level of significance

In the above table (2) the average abnormal returns (AARs), respective t-statistics and also cumulative average abnormal returns (CAARs) for rating upgrades are presented for 15 (-7, 0, +7) days event window. The above table demonstrates negative and insignificant average abnormal return (AAR) on the event date and whole of the event window and therefore definitely not distinctive from zero. The t-values of all the 15 (-7, 0, +7) days event window are insignificant. The table also shows negative and insignificant cumulative average abnormal returns (CAARs). From the above table, the post event window shows all negative cumulative average abnormal returns (CAARs). Existing prior studies revealed no or positive abnormal returns for upgrades. But in this study, it's hard to say the reason why cumulative average abnormal returns for the post event window are negative. From the above results it can be concluded that there is no significant effect on stock returns before and after the rating upgrades. This result can also certainly imply that some sort of credit rating upgrade doesn't have any informational value.

Figure 1. Upgrade Average Abnormal Returns

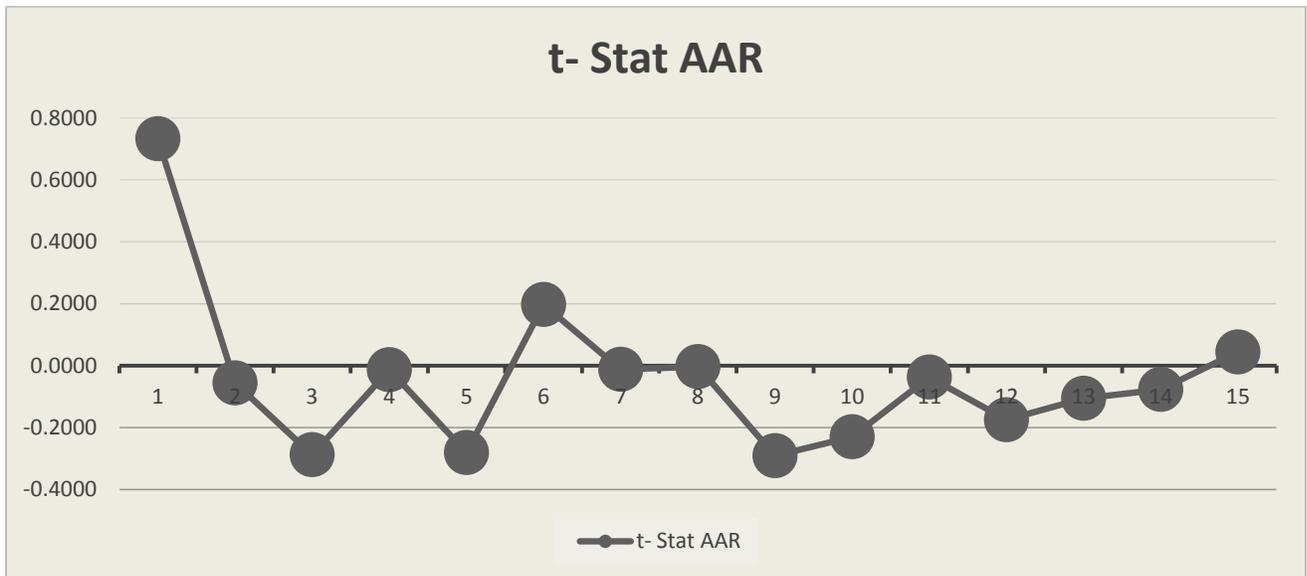


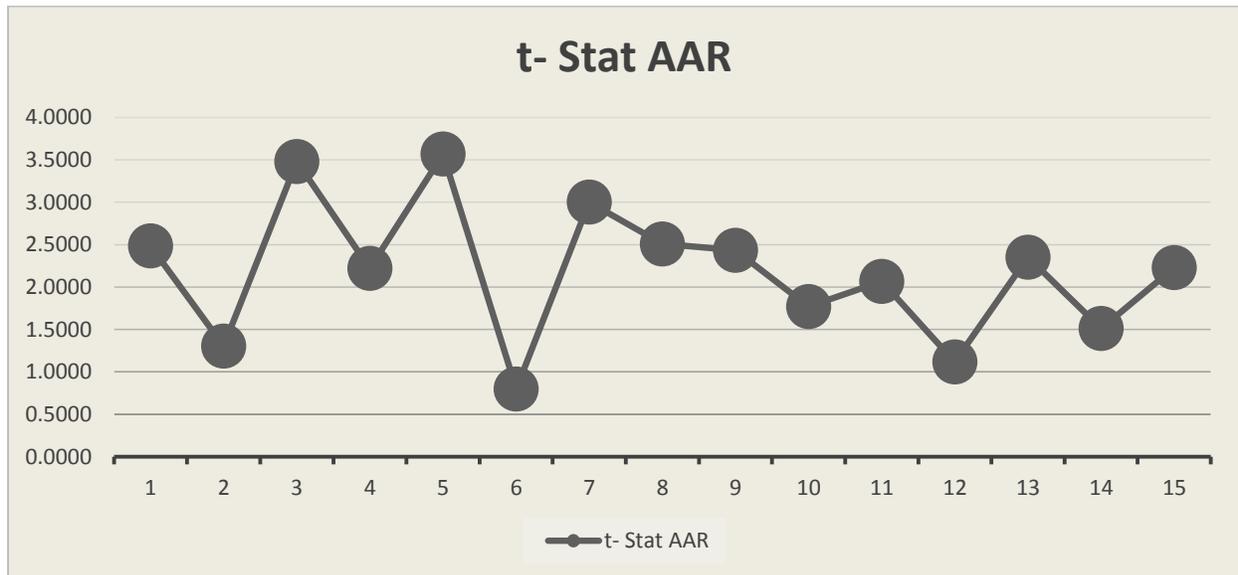
Table 3
Average Abnormal Returns (AAR) and Cumulative Average Abnormal Returns (CAAR)
and t-statistics for Rating Downgrades

Days	AAR	t- Stat AAR	CAAR	t-Stat CAAR
-7	0.0881	2.4860**	0.0881	2.4860**
-6	0.0462	1.3043	0.1343	3.7903***
-5	0.1233	3.4802***	0.2576	7.2706***
-4	0.0787	2.2209**	0.3363	9.4914***
-3	0.1265	3.5693***	0.4627	13.0608***
-2	0.0283	0.7982	0.4910	13.8590***
-1	0.1064	3.0024***	0.5974	16.8615***
0	0.0889	2.5081**	0.6863	19.3696***
1	0.0862	2.4334**	0.7725	21.8030***
2	0.0627	1.7705*	0.8352	23.5735***
3	0.0732	2.0671**	0.9084	25.6406***
4	0.0396	1.1176	0.9480	26.7582***
5	0.0833	2.3523**	1.0314	29.1105***
6	0.0536	1.5123	1.0850	30.6228***
7	0.0790	2.2299**	1.1640	32.8527***

Note: ***, **, * indicate 1%, 5% and 10% level of significance

In the above table (3) the average abnormal returns (AARs), respective t-statistics and also cumulative average abnormal returns (CAARs) for rating downgrades are presented for 15 (-7, 0, +7) days event window. The above table demonstrates positive and significant average abnormal return (AAR) on the event date and whole of the event window and therefore definitely statistically distinctive from zero. The t-values of all the 15 (-7, 0, +7) days event window are significant at 1%, 5% and 10% percent. The table also shows positive and significant cumulative average abnormal returns (CAARs). On event date cumulative average abnormal return equals to 0.6863 and significant at 2 % level.

Figure 2. Downgrade Average Abnormal Returns



Discussion

The main objective of this study is to investigate the effect of credit rating announcements on daily stock returns for banks indexed in Karachi Stock Exchange (KSE). Evident in results all banks individually generated insignificant average abnormal returns (AAR). On the notion of this analysis; the credit rating announcements do not have impact on stock returns. These results are in line with the prior studies of Holthausen and Leftwich (1986), first paperwork simply by Weinstein (1977); Pinches and Singleton (1978) and also Wakeman (1998) uncover simply no significant effect regarding credit ratings announcements about stock returns. But in contrast Griffin and Sanvicente (1982); Wansley and Clauretje (1985); Gropp and Richards (2001); and Creighton, Gowe, and Richards (2007) nonetheless, spawned evidence of abnormal behavior of share price after the announcements of credit rating.

The results of this study show the significant cumulative average abnormal return for rating downgrades but insignificant cumulative average abnormal return for rating upgrades. While taking a look at the results of rating upgrades, this study stumbled upon negative insignificant cumulative average abnormal return. These results are in line with the prior studies of Holthausen and Leftwich (1986); Steiner and Heinke (2001) and Creighton, Gowe, & Richards (2007) discovered insignificant abnormal returns for rating upgrades but in contrast Elayan, Hsu, and Meyer (2003) find positive significant cumulative average abnormal return. Numerous reasons behind the negative abnormal returns are usually witnessed for rating upgrade announcements. Hunting first at plausible elucidations conceding that positive (upgrade) rating actions are in connection with negative stock returns intended for Pakistani banks, the reason for the news ought to be taken into consideration. Good logical reason identified pertaining to downgrades; if the benefit of a company's assets is actually anticipated to remain unaffected, positive rating actions tend to be awful news for the company's shareholders.

Even more, imagine that the positive rating action on account of lower leverage could be considered as negative by the market while this implies less cash availability for the expansion of general business. Risk and also required return pertaining to stock holders will probably be lower which has debt to equity ratio. Nevertheless, when this is the scenario for the some of the events, the market may appear to gauge that these positive factors don't make up for less embryonic factors and lost growth potential.

Still, it's hard to accept as a true that there's a systematic link between positive rating press release (publication) and decrease in the stock price for the rating actions. Thus determine the other reasons outlining the results. One cause might be that the return for positive pronouncements pursues a randomly syndication, knowing that this development in the share price can be swayed simply by other events than any credit rating action. This reason may also be doable that price is exaggerated by other factors which often will not recognize and still have abortive to take into consideration whilst sorting the observations.

One more rationalization for these negative and unusual returns could possibly be that investors are not that concerned about positive rating announcement, signifying that positive credit rating news is a “non-event” for Pakistani banks. And also this signifies that different other factors influence the stock returns throughout the rating pronouncements. Additionally, the credit rating agency could possibly be depositing more efforts in the analysis of a negative pronouncement. If the market takes on or predicts this specific, it might get them to a lesser amount of awareness of the positive information. In last, logic for negative abnormal returns of rating upgrade is explained by Goh and Ederington (1993) and argued that the positive news (upgrade) is not a good news for stock holders therefore the credit rating agency given the higher priority to bond holders than stock holders. However Hun Han et al. (2009) spawned the evidence of negative significant abnormal returns for upgrades even though they don't have any justification for these results. As stated, assume that credit rating agency's risk assessment has less central role in Pakistani market related regulations and overall market in general. If this assessment is correct then it suggests that market consider the other factors and news for the valuation of positive news at least.

The results demonstrate the significant average abnormal returns (AARs) and cumulative average abnormal returns (CAARs) for rating downgrades. These results are match with the results of prior studies e.g. Hand, Holthausen, and Leftwich (1992); Goh and Ederington (1993); and Linciano (2004), which entail the credit rating downgrade leads to the decrease in stock prices. But this study produce positive average abnormal returns and cumulative average abnormal returns (CAARs) for rating downgrade which is contradict with prior studies but aligned with the observations of Zaima and McCarthy (1988) about the positive share price reactions to credit rating announcements. These positive abnormal returns may create bad news for stockholders because initial Zaima and McCarthy, (1988) and then Goh and Ederington (1993) hypothesize the predicted transfer connected with wealth by bondholders to stockholders needs to be very good news intended for stockholders but not in case of positive abnormal returns for downgrades of banks losses the wealth so this line of argument aligned with Schweitzer, Szcwcyk and Varma (1992) investigation. The results indicate that the downgrade ratings may be anticipated because the market significantly reacts before the rating announcement. The study exhibits that there are significant results after and before announcement of rating downgrade. That entails that

the market is not efficient in managing and handling the rating downgrade information because event window shows the abnormal returns after the downgrade rating announcement.

Holthausen and Leftwich (1986) dispute of which downgrades are certainly not important detrimental to shareholders. Additionally, particularly, Berk and DeMarzo, (2007) demonstrated that if the downgrade arises for the reason that company is usually dealing with more debt, perhaps it will move wealth through bondholders to shareholders. Wansley and Clauretje (1985); Holthausen and Leftwich (1986); and along with Goh and Ederington (1993) discovered substantial returns before announcements, showing some anticipation and expectancy. For the reason that credit rating agencies post a quick elucidation for their proclamation of credit rating, Goh and Ederington (1993) hypothesize that the market response will likely be contingent with this motive. They claim that one could not anticipate finding a significant negative stock impulse for all downgrades, due to the fact a good predicted transfer connected with wealth by bondholders to stockholders needs to be very good news intended for stockholders. Therefore, any credit rating downgrade can call for a positive share value impulse.

Because of regulations, the rating changes of financial firms should have less impact on stock returns as compared to rating changes of non-financial firms. Schweitzer, Szewczyk, and Varma, (1992) located different results in comparison with anticipated. A possible justification associated with Schweitzer, Szewczyk and Varma (1992) is that banking regulators may clutch and not disclose the adverse information to retain the confidence of depositor in a troubled bank and in addition to retain the bank's capability to magnetize capital in the markets. To preserve the stability of banking system the banking regulators may conceal the negative news. From the above results and discussion, conclude that the negative information has more impact on stock returns than positive information.

6. Conclusion

The main objective of this study is to investigate the effect of credit rating pronouncements on daily stock returns for banks indexed in Karachi Stock Exchange (KSE) from the periods of 2008 to 2014. The dataset comprises of total 154 credit ratings announcements. Event study is employed to calculate abnormal returns over the 7 days event window. Credit ratings tend to be one of the several tools in which investors may use when making decisions regarding the purchasing bonds along with other fixed income investments. In general, a credit rating is an opinion about the creditworthiness and ability of an obligor (issuer), or with respect to a meticulous debt security or any other financial obligation at a specific date.

Evident in results of this study, all banks individually generated insignificant average abnormal returns (AAR). On the notion of this analysis; the credit rating announcements do not have impact on stock returns. The results of this study show the positive significant cumulative average abnormal return for rating downgrades but insignificant cumulative average abnormal return for rating upgrades. While taking a look at the results of rating upgrades, this study stumbled upon negative insignificant cumulative average abnormal return. The results indicate that the downgrade ratings may be anticipated because the market significantly reacts before the rating announcement.

The study exhibits that there are significant results after and before announcement of rating downgrade. That entails that the market is not efficient in managing and handling the rating downgrade information because event window shows the abnormal returns after the downgrade rating announcement. A possible justification and explanation associated with Schweitzer, Szewczyk and Varma (1992) is that banking regulators may clutch and not disclosed the adverse information to retain the confidence of depositor in a troubled bank and in addition to retain the bank's capability to magnetize capital in the markets. From the results, conclude that the negative information has more impact on stock returns than positive information.

Working on this study, acknowledged the matters and as well take into account to the better indulgent of how a credit rating agency influences the stock market. The result of this study lifted a number of issues and suggestions which must be addressed in future research. First, getting more data about rating actions from the credit rating agency would certainly make tests more vigorous and robust. An appealing suggestion for the further investigation could be to perform different analysis of the upgrades and downgrades in bull and bear markets. Another suggestion for the future investigation could be to test more observations of the long term and short term rating changes separately and also test effect of information value to solicited and unsolicited ratings when rating changes. Further research is needed to cover the effects of intra-day stock price movements and trading volume. Another area of interest is to looking the changes in cost of capital and or the liquidity due to the rating actions.

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