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Do Investors Overreact to Earnings Surprises? Evidence from NIFTY 100

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Abstract
This study takes a closer look at how investors react to earnings surprises from the Nifty 100 companies for Q3 from the financial year 2022-2025. Earnings announcements are financial events that can bring in a change in stock prices, often driven by the emotions of investors. This research analyzes the percentage change in the stock prices after the earnings announcement has been made to determine the investors' overreaction to the unexpected earnings, if any. We have assessed the post-earnings stock price pattern to understand market efficiency and the implications of earnings surprises. By analyzing cumulative abnormal returns (CAR) in the days following earnings announcements, we assess whether investors exhibit overreaction and subsequent correction. The research differentiates between negative and positive surprises, applying a paired t-test and the Wilcoxon Signed Rank Test to evaluate statistical significance. Additionally, normality tests were conducted to determine the appropriate statistical approach, ensuring the robustness of results.
Key Words: Earnings announcements, Nifty 100, Financial markets, Market efficiency, Cumulative abnormal returns, Earnings Surprises

Introduction

In the world of financial markets, we have seen how stock prices are constantly changing, and this is mostly because of factors such as how well the company is performing, what investors are feeling, and the overall state of the economy. One of the most important events in this context is the earnings announcement, which sheds light on the company's financial health in one way and can significantly sway stock price movements. Publicly listed companies typically share these reports on a quarterly or annual basis, highlighting financial figures such as revenue, net income, and earnings per share. Alongside these reports, companies also hold earnings calls where the executives talk about the financial results, their business strategies, and what they are planning for the future, all while answering the questions. These announcements and discussions can greatly influence what the investors expect, often leading to fluctuations in the stock price.

An important element of earnings announcements is the idea of earnings surprises, which happens when the EPS, which the company reports, is notably different from what the analysts have predicted. If a company reports a positive earnings surprise (actual EPS is greater than expected EPS), it can boost investor confidence and push stock prices higher. On the flip side, a negative earnings surprise

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(actual EPS is less than expected EPS) might trigger panic selling and cause stock prices to drop sharply. However, the way stock prices react to these surprises isn't always logical. Behavioral biases, especially among investors, can lead to overreactions, resulting in wild price swings that are often followed by corrections in the days that follow.

Literature Review

Fama, Fisher, Jensen, & Roll (1969) laid the groundwork for event study methodology by demonstrating that stock prices should rapidly reflect new public information, thereby supporting the semi-strong form of the Efficient Market Hypothesis (EMH). Their work established the expectation that earnings announcements would be immediately incorporated into prices, providing a benchmark against which anomalies can be measured.

Bernard & Thomas (1990) challenged the notion of immediate price adjustment by documenting the Post-Earnings Announcement Drift (PEAD), whereby stocks continue to drift in the direction of the earnings surprise well beyond the announcement day. This finding suggests that markets may not be fully efficient in processing earnings information, especially in the short term.

Jegadeesh & Livnat (2006) further explored the impact of earnings surprises by linking forecast errors to subsequent abnormal returns, reinforcing the idea that information from earnings announcements is not completely impounded in stock prices immediately. Their results imply that earnings surprises have a predictive power for future price movements, contributing to the observed PEAD phenomenon.

Barber & Odean (2008) examined the influence of retail investor behaviour on stock returns and found that heightened retail trading activity can amplify price responses around earnings announcements. Their research highlights that behavioural factors—such as overreaction or delayed adjustments by retail investors—can play a significant role in the market's efficiency, particularly in markets with a large retail investor base.

Kaul (2002) investigated market efficiency in the Indian capital market and found mixed evidence regarding the speed and completeness of price adjustments following earnings announcements. This study underscores the importance of examining earnings-driven price dynamics in emerging markets, suggesting that large-cap stocks (e.g., those in the NIFTY 50) may process earnings information differently compared to their counterparts in developed markets.

Francis, Lafond, Olsson, & Schipper (2007) examined the role of information uncertainty in the magnitude of the Post-Earnings Announcement Drift (PEAD). Their findings suggest that stocks with higher uncertainty—measured through earnings volatility and analyst forecast dispersion—experience a stronger and more persistent drift following earnings announcements. This study highlights that not all earnings surprises are processed equally by investors; rather, uncertainty influences the speed and efficiency of price adjustments. Their work reinforces the idea that market participants struggle to fully integrate uncertain earnings information, leading to prolonged price adjustments over time.

Liu, Strong, & Xu (2003) extended the study of PEAD to the UK market, testing whether the phenomenon persists outside the US. Their findings confirm that stocks experiencing positive

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(negative) earnings surprises tend to drift upward (downward) for weeks after the announcement. More importantly, they found that larger firms exhibit a weaker PEAD effect compared to smaller firms, suggesting that liquidity, institutional ownership, and investor sophistication play a role in post-announcement pricing efficiency. Their research provides international validation of PEAD, challenging the notion that the anomaly is specific to the US equity markets.

Chen, Gao, & Liu (2021) investigated the role of limited investor attention in explaining PEAD in China's stock market. Their study found that stocks with lower pre-announcement trading volume and lower media coverage exhibit a stronger post-earnings drift, suggesting that when investors fail to immediately react to new information, the price adjustment process becomes slower. Their findings align with attention-based theories of market inefficiency, demonstrating that information salience affects stock price adjustments. This study is particularly relevant for emerging markets like India, where retail investor participation is high and information asymmetry may contribute to delayed market reactions.

Guo & Huang (2019) further explored the role of media coverage in post-earnings announcement price adjustments. Their research found that earnings surprises covered by a greater number of news outlets tend to experience a smaller drift, whereas those receiving less media attention have a prolonged price correction period. This suggests that media acts as a catalyst in processing earnings information, reinforcing efficiency when coverage is widespread but exacerbating inefficiencies when coverage is limited. Their study contributes to the growing literature on information dissemination and investor behavior, emphasizing the role of financial journalism in shaping market efficiency.

Kausar (2017) examined whether PEAD and the predictive power of earnings levels are distinct market anomalies or part of the same underlying phenomenon. Using a large dataset, the study found that firms with persistently strong earnings tend to outperform over long horizons, suggesting that earnings trends contain predictive value beyond short-term surprises. However, this effect is more pronounced in firms with low analyst coverage, indicating that investor inattention and limited information availability contribute to both PEAD and long-term return predictability. This study provides a broader perspective on how earnings-related information influences stock prices beyond short-term reaction windows.

Hirshleifer, Lim, & Teoh (2009) investigated the impact of investor psychology and limited cognitive processing on the Post-Earnings Announcement Drift (PEAD). They proposed the Investor Inattention Hypothesis, which suggests that investors often fail to fully process earnings information due to cognitive constraints, leading to a delayed reaction in stock prices. Their findings showed that firms announcing earnings on high-news days (i.e., days with significant market-wide news or multiple earnings announcements) experience a stronger and more prolonged PEAD, indicating that when investors are distracted, they take longer to adjust to earnings surprises. This study reinforces the role of attention constraints and behavioral biases in market inefficiencies, explaining why PEAD persists despite widespread awareness of the anomaly.

Chordia, Goyal, Sadka, Sadka, & Shivakumar (2009) examined the relationship between liquidity and PEAD, finding that stocks with lower liquidity exhibit a stronger and more prolonged drift following

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earnings announcements. Their research suggests that transaction costs and market frictions prevent arbitrageurs from fully correcting mispricings, allowing PEAD to persist in less liquid stocks. They also discovered that institutional investors tend to trade in the direction of the drift, further reinforcing the anomaly. Their findings emphasize that market frictions, such as trading constraints and investor composition, play a crucial role in sustaining earnings-related anomalies in stock markets.

Ball and Kothari (1991) studied stock price changes after companies announce their earnings. They discovered that the market usually handles these announcements efficiently, but there is a bit of ongoing price movement after the announcements. This suggests that investors need some time to fully adjust their expectations.

Michels (2025) examined the impact of everyday investors, known as investors, on stock prices when earnings reports come out. The study showed that the actions of investors can result in delayed price changes and sometimes incorrect pricing.

Barron et al. (2002) investigated how financial analysts make predictions around earnings announcements. Their research indicates that these announcements help analysts provide more accurate forecasts, reducing differences in predictions.

Zahera and Bansal (2018) explored how investor behavior affects investment decisions. They found that investors may overreact or underreact to new information, such as earnings announcements.

DeFond and Park (2001) looked into the effect of unusual accounting adjustments on responses to unexpected earnings results. Their findings suggest that investors often anticipate these adjustments and account for them, showing skepticism toward earnings figures.

Mallikarjunappa & Dsouza (2013) examined the semi-strong form efficiency of the NIFTY 50 index by analyzing stock price reactions to rights issue announcements. Their findings suggest that Indian markets incorporate new information quickly but exhibit signs of short-term inefficiencies, particularly for less liquid stocks.

Srinivasan (1997) investigated security price behavior around rights issue-related events and found that stock prices adjust significantly before the announcement, indicating potential information leakage or speculative trading activity. His study suggests that market participants anticipate rights issues and incorporate expectations into prices in advance.

Obaidullah (1990) analyzed stock price reactions to bonus issues in India and found that while prices respond positively to such announcements, a portion of the price adjustment occurs before the official declaration, implying an element of pre-announcement speculation.

Ertimur, Livnat, and Martikainen (2003) found that investors react more strongly to revenue surprises than expense surprises, with market responses influenced by firm characteristics like growth vs. value classification. Their study highlights the importance of analyzing earnings surprises in the context of revenue and expense dynamics rather than in isolation.

Francis and Ke (2003) found that SEC-mandated fee disclosures lowered market valuations of earnings surprises for firms with high nonaudit fees, signaling investor concerns about auditor independence.

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Myers, Myers, and Skinner (2007) examined firms reporting long streaks of consecutive EPS increases and found that these firms experience abnormal returns of over 20% annually during the streak. Their findings suggest earnings management plays a role in maintaining these streaks, as managers use various tools to sustain investor confidence.

Chordia and Shivakumar (2006) investigated the relationship between earnings momentum and price momentum, finding that price momentum is largely driven by systematic earnings surprises. Their study highlights that a zero-investment strategy based on earnings surprises outperforms past return-based strategies and is significantly linked to future macroeconomic indicators.

La Porta et al. analyzed stock price reactions to earnings announcements for value and glamour stocks, finding that value stocks experience systematically more positive earnings surprises. Their study suggests that the return premium of value stocks is driven by investor expectational errors rather than risk-based factors, reinforcing market inefficiency.

Walther (1997) examined the role of investor sophistication in forming market earnings expectations. The study found that less sophisticated investors tend to overreact to earnings announcements, while more sophisticated investors adjust their expectations more efficiently, influencing post-earnings price movements.

Research Objectives

1. Analyze the stock price movements in the five days following earnings announcements to identify patterns indicative of overreaction.
2. Provide insights into the implications of such behaviors for market efficiency and investor decision-making.

Research Gaps

Existing research on earnings surprises and stock price reactions, primarily in developed markets, highlights anomalies like the Post-Earnings Announcement Drift (PEAD) (Bernard & Thomas, 1990; Jegadeesh & Livnat, 2006) and behavioral biases influencing price adjustments (Barber & Odean, 2008; Zahera & Bansal, 2018). In India, Kaul (2002) found mixed evidence on market efficiency, but limited studies analyze multi-year earnings reactions in large-cap stocks. This study fills the gap by examining NIFTY 100 companies and Q3 earnings surprises over four financial years (2021-22 to 2024-25) to assess whether price reactions exhibit overreaction, correction, or prolonged adjustments. Using paired t-tests and the Wilcoxon Signed Rank Test, we provide insights into market efficiency and behavioral biases in an emerging market. Our findings will benefit institutional and retail investors, academics, and policymakers by enhancing understanding of earnings-driven price movements and refining investment strategies.

Hypothesis

Null Hypothesis (H_0): investors do not overreact to earnings surprises among NIFTY 100 companies.
Alternative Hypothesis (H_1): investors overreact to earnings surprises among NIFTY 100 companies, leading to significant stock price movements in the days following earnings announcements.

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Methodology

1. Sample selection: The study focuses on the Nifty 100 index, which represents the top 100 companies listed on the National Stock Exchange of India.
2. Sorting of companies: To ensure consistency and accuracy, the study only included Nifty 100 companies that had both Estimated EPS and Actual EPS data available for all four Q3 periods. Companies with missing or incomplete data were excluded from the analysis. This filtering process ensured that the study focused on stocks where analyst expectations were consistently available, allowing for a meaningful comparison of earnings surprises and their impact on stock prices. 44 stocks were remaining, once the data was filtered.
3. Data Collection: The data was sourced from the Bloomberg Terminal, where we collected the data for the Actual EPS and estimated EPS for Q3 of the last four years. The earnings announcement dates were determined by looking at the publicly available financial reports. Additionally, the change in stock price data for the five trading days following the earnings announcement was taken from Yahoo Finance to analyse the post-earnings price movements.
4. Performance Metric: To measure how the market has reacted to the earnings surprises, we have calculated the earnings surprise % using this formula:

   Earnings Surprise(%)=[(Estimated EPS-Actual EPS)/ Estimated EPS] x 100

   To evaluate how stock prices responded, the study tracked the percentage change in stock prices from the earnings announcement date up to five days later. This approach helped identify if there were any significant abnormal price movements following those earnings surprises.
5. Abnormal Returns: Returns over and above the NIFTY 100 index returns for a particular day were calculated to adjust for returns that were solely earned due to market movement. This was done for the daily returns of a stock for 5 days post the earnings announcement.

   Abnormal Return Stock return- Nifty 100 Return
6. Cumulative Abnormal Returns: The first 2 days were considered the Immediate Market Reaction (CAR1_2), and the remaining 3 days were considered the Correction Period (CAR3_5).
7. Statistical Analysis: A paired sample t-test and Wilcoxon Signed Rank test were conducted for this study. This test compared cumulative stock price changes on the first two days after the earnings announcement with stock price changes on days three to five. The purpose was to determine whether the initial price movement was followed by a correction, which would indicate overreaction by investors.

Data Analysis and Findings

The paired samples t-test is an inferential statistical technique used to determine whether there is a significant difference between the means of two related groups. In this study, it was employed to compare the cumulative abnormal returns (CAR) in the immediate post-earnings window (Days 1-2) with those in the subsequent correction period (Days 3-5) for stocks experiencing earnings surprises. This test was chosen because it is well-suited for evaluating whether the same set of stocks exhibits significant changes in returns over two different periods, thereby allowing us to assess the presence

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or absence of a corrective price movement following the earnings announcement. However, this test has a normality assumption that did not hold for all 4 years. So, for the years when the normality assumption was violated, the Wilcoxon Signed Rank test was used. The data was filtered, and the paired sample t-test, or Wilcoxon Signed Rank test for the negative surprises and the positive surprises, was conducted separately.

As the primary objective of this paper is to assess whether the stock market overreacts to earnings announcements and whether this reaction is corrected in subsequent trading days, the paper focuses on two key cumulative abnormal return (CAR) periods:

- **CAR1_2:** This measures the immediate stock price reaction (Day 1 to Day 2 after earnings announcement).
- **CAR3_5:** This measures the subsequent price movement (Day 3 to Day 5), which helps determine whether initial reactions were overreactions that later corrected.

The analysis is conducted separately for negative surprises (earnings below expectations) and positive surprises (earnings above expectations). A paired t-test is used to compare CAR1_2 and CAR3_5 to determine statistical significance. Additionally, the Wilcoxon Signed Rank Test is used when normality assumptions are violated.

Findings (Negative Surprises):

The results from the paired t-test for negative surprises are summarized below:

Paired Samples T-Test

Paired Samples T-Test

			statistic	df	p
CAR1_2_NS2021-22	CAR3_5_NS2021-22	Student's t	0.44803	23.00000	0.6708400082693401
CAR1_2_NS2022-23	CAR3_5_NS2022-23	Student's t	−0.54677	20.00000	0.2952919839443672
CAR1_2_NS2023-24	CAR3_5_NS2023-24	Student's t	−1.12381	21.00000	0.1368876932072086
CAR1_2_NS2024-25	CAR3_5_NS2024-25	Student's t	−0.14946	21.00000	0.4413065111056581

Note. H_a $\mu_{\text{Measure 1 - Measure 2}} < 0$

Normality Test (Shapiro-Wilk)

			W	p
CAR1_2_NS2021-22	-	CAR3_5_NS2021-22	0.96187	0.4770691150440188
CAR1_2_NS2022-23	-	CAR3_5_NS2022-23	0.96619	0.6481503055095439
CAR1_2_NS2023-24	-	CAR3_5_NS2023-24	0.97076	0.7284611810292733
CAR1_2_NS2024-25	-	CAR3_5_NS2024-25	0.96464	0.5882563299569924

Note. A low p-value suggests a violation of the assumption of normality

(Table no. 1&2: Negative Surprises t-test & Normality test)

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None of the years' data violated the normality assumption. So, a t-test was used for the negative surprises data.

The p-values for all four years are greater than 0.05, indicating that there is no statistically significant difference between CAR1_2 and CAR3_5, at a 95% confidence level. This suggests that stocks do not show a clear pattern of overreaction and correction following negative earnings surprises. The market response to bad earnings news appears to be relatively stable, without significant reversals in the days following the initial drop.

Findings (Positive Surprises)

For positive earnings surprises, the paired t-test and Wilcoxon test results are shown below:

Paired Samples T-Test

Paired Samples T-Test

			Statistic	df	p
CAR1_2_PS2021-22	CAR3_5_PS2021-22	Student's t	1.81362	19.00000	0.0427819344049991
		Wilcoxon W	146.00000		0.0663633346557617
CAR1_2_PS2022-23	CAR3_5_PS2022-23	Student's t	2.72025	22.00000	0.0062484192482373
		Wilcoxon W	213.00000		0.0106861591339111
CAR1_2_PS2023-24	CAR3_5_PS2023-24	Student's t	1.77027	21.00000	0.0455998437098653
		Wilcoxon W	175.00000		0.0603387355804443
CAR1_2_PS2024-25	CAR3_5_PS2024-25	Student's t	2.08854	20.00000	0.0248718792807113
		Wilcoxon W	164.00000		0.0478997230529785

Note. H_a $\mu_{\text{Measure 1 - Measure 2}} > 0$

Normality Test (Shapiro-Wilk)

			W	p
CAR1_2_PS2021-22	-	CAR3_5_PS2021-22	0.86079	0.0081256286213687
CAR1_2_PS2022-23	-	CAR3_5_PS2022-23	0.95138	0.3125641168939154
CAR1_2_PS2023-24	-	CAR3_5_PS2023-24	0.89780	0.0268735367648603
CAR1_2_PS2024-25	-	CAR3_5_PS2024-25	0.97167	0.7697285275752708

Note. A low p-value suggests a violation of the assumption of normality

(Table no. 3&4: Positive Surprises test & Normality Test)

(The assumption of normality was violated in 2021-22 and 2023-24, as per the Shapiro-Wilk test for normality. So, we look at the Wilcoxon Signed Rank Test when analysing the data for these years.)

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For years 2022-23 and 2024-25, the t-test p values were less than 0.05, allowing us to reject the null hypothesis. The Wilcoxon Signed Rank test p values for 2021-22 and 2022-23 were greater than 0.05; however, these values were still much closer to 0.05 when compared to the t-test p values of negative surprises. This suggests that stocks experience a strong positive reaction initially, followed by a partial reversal or correction in later days, at least for the alternating years.

This study aimed to determine whether the stock market overreacts to earnings surprises and whether this reaction is corrected in subsequent days. The findings indicate:

1. Negative earnings surprises do not lead to significant stock price overreactions, as the difference between CAR1_2 and CAR3_5 is not statistically significant. This implies that there is no meaningful price correction or reversal following the initial market reaction in the short term, suggesting that investors react efficiently to bad news without excessive pessimism.
2. Positive earnings surprises consistently exhibit statistically significant initial overreactions, followed by a correction in the subsequent days, for the alternating years. This implies that investors may initially overestimate the long-term impact of strong earnings, leading to short-term price spikes that later stabilize.
3. Over the four years, the pattern remains stable, for both types of surprises. Negative surprises are consistently efficiently factored in by the market, and positive surprises have a p-value that is either significant or close to being significant, reinforcing the hypothesis that positive earnings surprises lead to temporary market inefficiencies, while negative earnings surprises do not.

Implications:

- Investors, especially swing traders, should be cautious about chasing stocks after strong earnings beats, as a correction is likely.
- Markets appear to price in bad news efficiently but struggle with excessive optimism when earnings exceed expectations.

Conclusion

The analysis of market reactions to earnings surprises over four years reveals a consistent asymmetry in investor behavior. Negative earnings surprises do not lead to statistically significant overreactions, indicating that the market efficiently incorporates bad news without the need for a corrective adjustment. The absence of a significant post-announcement price reversal for negative surprises suggests that, at least for NIFTY 100 stocks, negative earnings surprises do not create exploitable mispricings, thereby limiting the potential for trading strategies based solely on these events. In contrast, positive earnings surprises consistently trigger an initial overreaction, followed by a subsequent correction, suggesting that investors tend to be overly optimistic in the short term before adjusting their expectations. This pattern persists across alternate years, reinforcing the idea that investor sentiment plays a crucial role in post-earnings price movements. These findings suggest that traders should be cautious when reacting to strong earnings beats, as the likelihood of a short-term correction is high. Moreover, the results highlight inefficiencies in the market's response to good

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news, presenting potential opportunities for trading strategies that exploit these predictable corrections.

Limitations

1. Focus on only NIFTY 100 - This study is limited to the larger cap, established, well-recognized companies forming the NIFTY 100 index, and takes into consideration their earnings call surprises and subsequent stock price reactions. This is most likely not applicable to some mid-cap or small-cap stocks, where it is possible that price inefficiencies are much greater.
2. Short-Term Event Window - The analysis makes use of a shorter event window (Days 1-2 for initial reaction and Days 3-5 for correction), which does not take into consideration possible market reactions that are delayed. Markets might embed earnings surprises over longer periods, which would require longer study windows.
3. Retail vs. Institutional Investor Effects - While the study assumes market efficiency in incorporating earnings information, it does not separately analyse how institutional investors and investors contribute to price adjustments.
4. Magnitude of surprises not considered- Magnitude of the percentage of earnings surprises was not considered in this paper, while analysing the data.

Future Scope

1. Extending the Study to Mid- and Small-Cap Stocks – Future research can explore whether earnings surprises have stronger or weaker effects in less-liquid, more volatile segments of the market, where information asymmetry is higher.
2. Examining Longer-Term Price Adjustments – A study covering post-earnings stock performance over multiple weeks or months can determine if price corrections extend beyond the short-term window considered in this paper.
3. Retail vs. Institutional Trading Influence – A future study could differentiate between an institutional investor's behaviour in response to earnings news, identifying whether one group is more prone to overreaction or delayed price adjustments.
4. Analysing the trend for Positive Surprises over the years – Seeing whether the market gets more efficient as time goes on, or if there is a trend in alternate years.

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