

## **Parliamentary Elections and Stock Performance: A Comparison of American Depository Receipts and their Underlying Equities in India.**

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### **ABSTRACT**

National political elections impact stock market performance (e.g., Ying, Rasiah, & Ming, 2016). However, prior studies rarely report the simultaneous impact of election results on stock performances and their corresponding depositories listed offshore. Filling this research gap, the purpose of this article is to compare the impact of the 2014 India Parliamentary Election on the short-term average abnormal returns (AARs) and cumulative average abnormal returns (CAARs) of equities traded in India's National Stock Exchange (NSE) and their corresponding American Depository Receipts (ADRs) traded in the United States. Using a short-term event window, this article proposes that India's national parliamentary election results of a Modi win in 2014 have a larger impact on the performance of the local underlying equities than their corresponding ADRs. The results found support for the main hypothesis. The CAARs of ADRs were lower than those of underlying Indian equities were, immediately before and after the elections. The results indicate that the news of a significant political event affect the short-term returns of ADRs and underlying equities traded in India in slightly different ways. These findings have implications for portfolio managers, as well as for the security regulatory authorities in India.

**Keywords:** National Election, American Depository Receipts, National Stock Exchange of India, Average Abnormal Returns, Cumulative Average Abnormal Returns.

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### **1. INTRODUCTION**

In 2014, the results of the Parliamentary elections in India were very important and impactful. This is because after 30 years, this is the first time a single political party (BJP or Bharatiya Janata Party) won majority status in the Lower House (Lok Sabha) of the Parliament of India. Mr. Narendra Modi, the leader of BJP became the Prime Minister of India (Tillin, 2015). Just prior to 2014 elections, Indian stock market reached new heights, because of the expectation that Mr. Modi, a champion of economic growth, would steer BJP to victory in the Parliamentary elections (Loomba, 2014). The short-term performance of India's stock market surrounding the Parliamentary elections is the focus of this study. Did the election results have

a positive or a negative impact on India's stock market performance? Also, did the election results impact the American Depository Receipts (ADRs) of India equities?

Like firms from other countries, firms in India rely on the U.S. financial market. The attractiveness for foreign companies to use U.S. bourses to raise capital is based on the large size of U.S. financial market that attracts new capital, liquidity (Diamond and Verrecchia, 1991), and relatively transparent governance for listings (Chemmanur and Fulghieri, 2006). By issuing American Depository Receipts (ADRs) multi-national companies can access funds from US markets for both short-term and long-term debt financing (Haar, Haar, & Dandapani, 1990).

From an investor's point of view, US investors purchase ADRs in order to increase portfolio diversity (Arnold, Nail, and Nixon, 2004). . Prior studies have shown that ADRs have more positive returns than U.S. Indices such as S&P 500 or NASDAQ (e.g., Schaub 2012, 2016). Nandy & Sussan (2019) found that in the long run the compounded returns obtained from pharmaceutical ADRs are higher than that of S&P 500. However, the results were different when the time window was short-term. Nandy & Sussan (2018) reported that the differences in the short-term Sharpe ratios of pharmaceutical ADRs, and US pharmaceuticals were not statistically significant. These mixed results suggest that the time window has varying impact on ADRs performances.

Combining the time window impact on ADRs performance and the impact of national parliamentary election results on India's stock market performance, this article proposes that the impact of parliamentary election results on India's local stock market and their corresponding ADRs will differ. There is yet reported research that compares the financial returns of ADRs of Indian companies and of the underlying equities traded in National Stock Exchange (NSE) of India, before and after Parliamentary elections in India. The current research work intends to fill this the gap. Based on uncertainty information hypothesis (Brown, Harlow, and Tinic, 1988) and prior studies that reported support for such hypothesis (e.g., Pantzalis, Strangeland, and Turtle, 2000), there is reason to believe that Parliamentary elections in India in 2014 have an impact on the stock market in both the National Stock Exchange of India (NSE) and ADRs issued by Indian companies that are also traded at NSE. From an efficient market perspective, Singh and Chakravarty (2017) reported that the Hurst coefficient values of Indian ADRs tend to be lower than that of the corresponding equities traded in NSE, suggesting that the US stock market is more efficient than the Indian stock market. This leads to our proposition that the impact of Parliamentary election in India 2014 will have a larger impact on stock performances in NSE when compared to the corresponding ADRs.

In order to capture the impact of the national elections, this article uses event study methodology. Event-study methodology has been used in the past to determine the short-term effects of national election on the returns of equities in Greece and in Malaysia (Repousis (2016); Ying, Rasiah & Ming (2016)). Similar to these prior studies, this article uses event-study to measure the short-term impact of 2014 Parliamentary elections in India on the returns of Indian ADRs and the underlying equities traded in National Stock Exchange (NSE) of India.

The remaining of the paper begins with a brief literature review followed by the details of the evaluation of the abnormal returns. Stock market data of eight Indian companies with ADRs traded in New York Stock Exchange and NASDAQ were selected for this study. Stock market data of the same eight Indian companies traded in National Stock Exchange of India were also selected. Results of event study follows with discussions, conclusion, and managerial implications.

## 2. LITERATURE REVIEW

### 2.1 Political Event and Stock Market Performance

Prior research has measured the impact of national elections on stock market performances around the globe (e.g., Oehler, Walker & Wendt, 2013; Repousis, 2016; Ying, Rasiah & Ming, 2016). From 1980 to 2008 US Presidential elections, Oehler et al. (2013) found that the victory of a Democratic presidential candidate resulted in negatively stock returns. On the other hand, Oehler et al. (2013) reported that the results were mixed for the victory of Republican candidates.

For Greece's political elections, Repousis (2016) studied the impact of 2000, 2004, and 2007 elections on bank stocks but found no evidence of such impact. More specifically, cumulative average abnormal return (CAAR) of the stocks of Greek banks before and after the Greek elections in 2000, 2004 were slightly positive in pre-election and slightly positive in post-election but not statistically significant. For the 2007 Greek elections, the CAAR of Greek bank stocks were slightly positive during pre-election but slightly negative in post-election, again not statistically significant. Because the CAARs were not statistically significant, Repousis (2016) concluded that the two major political parties were not able to manipulate the stock prices of Greek banks for political purposes. Mahmood, Irfan, Iqbal, and Kamran (2014) measured the impact of political events on the abnormal returns of Karachi Stock Exchange (KSE)100 Index and found negative CARRs of KSE-100 Index in windows of 30 days before, and 60 days after significant political events occurred in Pakistan.

For a shorter event window of 15 days, Ying, Rasiah & Ming (2016) analyzed the returns of Malaysian stocks before and after elections in Malaysia from the period from 2004 to 2013, and reported that both average abnormal return (AAR) and CARR occurred with the 15-day window before and after the elections are statistically significant. It was concluded that Malaysian stock market did not show the properties of semi-strong form of efficiency about dissemination of news of the elections (Ying, Rasiah & Ming, 2016). In other words, uncertainty of information existed in the case of Malaysia in that national elections impacted its stock market performance.

### 2.2 Information, Market Efficiency, and Event Study

The relationships of information, stock prices, and event study methodology are well documented. Fama, Fisher, Jensen & Roll (1969), Fama (1970) and Fama (1991) developed the methodology of event study based on efficient market hypothesis that states that security prices reflect fully all available information.<sup>1</sup> According to Fama (1991), event studies indicate that stock prices seem to adjust within a day to event announcement. Fama (1991) further stated that this quick adjustment of stock price to event announcement is consistent with market efficiency.

Within the India context, the impact of political risk on stock price performance has been studied by Dania & Verma (2007) who reported that the returns of ADRs of Indian

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<sup>1</sup> Corrado (2011) in a review on event studies opined that this methodology was originally developed to assist in empirical research in finance and in accounting. However, according to Corrado (2011), event studies were eventually used in various fields of study such as, in economics, history, law, management marketing, and political science.

companies traded in New York Stock Exchange were negative and statistically significantly impacted by the terrorist activities.

The impact of an event on stock prices is however subject to the width of the time window under investigation. For example, Eastman, Iyer and Wiggernhorn (2010) found that advertising in Super Bowl did not have a significant positive impact on a firm's stock price on the day after the Super Bowl. However, Eastman et al. (2010) found that there was a significant positive impact on stock prices when considering event windows from two to four days before and after the Super Bowl. For a much longer time window, Arora, Patel & Ubeja (2015) estimated CARR in a 90-day period after a launching event of an electric vehicle by an Indian car manufacturer Mahindra and Mahindra Limited and found it statistically significant with a 9% return.

### *2.3 Market Efficiency, Local Equities, and ADRs*

Markets worldwide vary in their efficiencies. The comparison of the impact of political events on ADRs and their underlying equities thus need to take into account the variance of market efficiencies as ADRs are traded in the U.S. and the underlying equities trade in local stock exchange – in this article in India. Singh and Chakravarty (2017) used Hurst coefficient to examine the differences in the efficiencies in financial returns of Indian ADRs and their underlying stocks. Hurst coefficient is a measure of the difference between the maximum and minimum values of the returns of the equities (standardized by standard deviation of the returns) within a specified period of study. The magnitudes of Hurst coefficient thus represent a measure of efficiency in a particular market (Singh and Chakravarty, 2017). Singh and Chakravarty (2017) found that Hurst coefficient values were lower in magnitudes for Indian ADRs at the beginning of their study period and declined to even lower values, compared to that of the corresponding equities in Indian stock exchanges at the end of the study period. Singh and Chakravarty (2017) concluded from this observation that the US stock market is more efficient than the Indian stock market, in terms of the trading of Indian ADRs.

## **3. METHOD**

In the current research, event-study method is used to determine the effect on the abnormal returns of American Depository Receipts (ADRs) of Indian companies traded in US stock exchanges, both immediately before and after the Parliamentary elections in India on May 16, 2014.

Eight Indian companies with ADRs traded in New York Stock Exchange and NASDAQ stock exchange were selected for this study, Daily ADR prices for the year 2014 (252 trading days) were obtained from <https://finance.yahoo.com/>. The following eight ADRs were studied:

1. HDFC Bank (ticker: HDB, market capitalization: \$80 billion)
2. ICICI Bank (ticker: IBN; market capitalization: \$28 billion)
3. Infosys Limited (ticker: INFY; market capitalization \$41 billion)
4. Wipro Limited (ticker: WIT; market capitalization: \$18 billion)
5. Dr. Reddy's Lab (ticker: RDY, market capitalization: \$5.9 billion)
6. Tata Motors Limited (ticker: TTY; market capitalization: \$14.7 billion)
7. Vedanta Limited (ticker: VEDL; market capitalization: \$12.89 billion)
8. WNS (Holdings) Limited (ticker: WNS: market capitalization \$2.67 billion)

These ADRs were selected because the underlying equities of these companies were also traded in National Stock Exchange (NSE) of India (<https://in.finance.yahoo.com/>). Daily prices of these equities for the entire year of 2014 (246 trading days) were obtained

The market return of an ADR is calculated as follows: (Corrado (2011), Repousis, (2016)):

$$R_{it} = (M_t - M_{t-1}) / M_{t-1}$$

where,  $R_{it}$  = Market return on day  $t$  for ADR  $i$

$M_t$  = Market price of ADR  $i$  on day  $t$

$M_{t-1}$  = Market price of ADR  $i$  on day  $t-1$

Abnormal return (or residual returns) of ADR  $i$  for day  $t$  is calculated as the difference between actual and average daily return, which is given by

$$AR_{it} = R_{it} - (1/N) \sum R_{it}$$

where the second term indicates the average daily return for ADR  $i$  for the entire year ( $N = 252$  trading days in US stock exchanges in 2014).

The average abnormal return of all eight ADRs for day  $t$  is calculated as:

$$AAR_t = (1/N) \sum AR_{it}$$

where,

$AAR_t$  = average of abnormal returns of all eight ADRs for day  $t$

$N = 8$  (Total number of ADRs)

and  $\sum AR_{it}$  = sum of abnormal returns of all eight ADRs for day  $t$ .

Cumulative average abnormal returns from the starting point  $T_1$  of a time window to the end-point  $T_2$  is calculated as:

$$CAAR(T_1, T_2) = \sum AAR$$

In the above expression, the summation is obtained for the AARs of the eight ADRs from time  $T_1$  to time  $T_2$ .

Brown & Warner (1985) and Berry, Gallinger & Henderson (1990) documented that in conducting event studies - parametric hypothesis tests can be used because the daily abnormal stock returns are normally distributed.

Based on prior research findings, we have reason to believe that the AARs and CAARs of equities will differ from zero. More formally, we hypothesize:

- H1. Ceteris Paribus, the AARs will differ from zero, and*  
*1. H2. Ceteris Paribus, the CAARs will differ from zero*

The  $t$ -statistics are calculated as follows (Corrado (2011), Repousis, (2016)):

$$t_{AAR} = AAR / S_{AAR}, \text{ and}$$

$$t_{CAAR} = CAAR / [(T^{0.5})(S_{AAR})]$$

where the standard deviation is given as:

$$S_{AAR} = \{[\sum AAR^2 / (T_0 - 1)]\}^{0.5}$$

Here the summation is obtained for the squares of the average abnormal returns for the eight ADRs for the time-period  $T_0$ , and

$T$  = Number of days in the time window used in calculation of CAAR.

#### 4. RESULTS

Table 1: Hypothesis Tests on Average Abnormal Returns

Panel A: Trading days before the election (data from National Stock Exchange, Mumbai)

INDIA	Day -1	Day -2	Day -3	Day-4	Day-5
Mean	-0.021	0.001	0.022	0.014	0.020
<i>t</i> -statistic	-1.119	0.076	1.128	0.714	1.034
<i>p</i> -value	0.276	0.940	0.273	0.483	0.313

Panel B: Trading days before the election (data from US Stock Exchanges, New York)

USA	Day -1	Day -2	Day -3	Day-4	Day-5
Mean	-0.012	-0.006	-0.011	0.035	0.023
<i>t</i> -statistic	-0.746	-0.377	-0.731	2.270	1.498
<i>p</i> -value	0.464	0.710	0.473	<b>0.034*</b>	0.147

It is observed from Panels A and B in Table 1 that the AARs of the equities in NSE and ADRs were negative on one day prior to the election day. The magnitudes of average abnormal returns (AARs) of the equities were about the same as those of ADRs. Panels A and B show the magnitudes of the *t*-statistic and the corresponding *p*-values. The high *p*-values suggest that the AARs of the equities traded in NSE could be equal to zero. This is also true for ADRs, except on the fourth day prior to the election. The low *p*-value on the fourth day prior to the election (marked with bold asterisk) suggest that the AAR could be different from zero.

Table 2: Hypothesis Tests on Average Abnormal Returns

Panel A: Trading days after the election (data from National Stock Exchange, Mumbai)

INDIA	Day +1	Day+2	Day+3	Day+4	Day+5
Mean	0.023	0.045	0.004	-0.007	0.050
<i>t</i> -statistic	1.222	2.348	0.214	-0.359	2.623
<i>p</i> -value	0.236	<b>0.029*</b>	0.833	0.723	<b>0.016*</b>

Panel B: Trading days after the election (data from US Stock Exchanges, New York)

USA	Day +1	Day+2	Day+3	Day+4	Day+5
Mean	0.003	0.019	0.006	-0.007	0.019
<i>t</i> -statistic	0.188	1.214	0.407	-0.471	1.247
<i>p</i> -value	0.852	0.239	0.688	0.643	0.227

Panels A and B in Table 2 show that the AARs of the equities and ADRs were positive on days one, two, three and five days after the election. This means that the election results impacted the AARs positively. The AARs were negative on the day prior to the election but became positive on the day after the election. However, the magnitudes of AARs of ADRs were less than, those of the underlying equities traded in NSE. The low p-values (marked with bold asterisk) in Panel A on the second and fifth day indicate that the AARs of equities traded in NSE could be different from zero. This suggests that the news of the Parliamentary elections could have impacted the AARs of the equities traded on NSE on the second and fifth day after the election. However, the high p values in Panel B, suggest that the AAR for the ADRs could be equal to zero. The magnitudes of the AARs were lower for the ADRs.

Table 3: Hypotheses Tests on Average Abnormal Returns

Panel A: Windows before and after the election (data from National Stock Exchange, Mumbai)

INDIA	W(+1,+3)	W(-1,+1)	W(-2,+2)	W(-3,+3)	W(-4,+4)
Mean	0.024	0.006	0.013	0.013	0.007
<i>t</i> -statistic	1,261	0.315	0.673	0.673	0.358
<i>p</i> -value	0.222	0.756	0.508	0.508	0.724

Panel B: Windows before and after the election (data from US Stock Exchanges, New York)

USA	W(+1,+3)	W(-1,+1)	W (-2,+2)	W (-3,+3)	W(-4,+4)
Mean	0.009	0.005	0.006	0.003	0.007
<i>t</i> -statistic	0.602	0.353	0.379	0.225	0.462
<i>p</i> -value	0.552	0/727	0.728	0.824	0.649

Panels A and B in Table 3 indicate that the mean values of AARs of the equities in NSE, and of the ADRs were positive on time windows consisting of two days, four days, six days and eight-days. The AARs of ADRs were less than, those of the underlying equities in NSE. The high p-values indicate that the AARs were equal to zero for ADRs as well as, for the equities in the time windows considered for this study.

Table 4: Hypotheses Tests on Cumulative Average Abnormal Returns

Panel A; Trading Days Before the election (data from National Stock Exchange, Mumbai)

INDIA	Day -1	Day -2	Day -3	Day-4	Day-5
CAAR	-0.005	-0.004	0.018	0.032	0.051
<i>t</i> -statistic	-0.196	-0.116	0.463	0.733	1.093
<i>p</i> -value	0.847	0.909	0.648	0.471	0.287

Panel B: Trading Days Before the election (data from US Stock Exchanges, New York)

USA	Day -1	Day -2	Day -3	Day-4	Day-5
CAAR	0.013	0.008	-0.004	0.031	0.055
<i>t</i> -statistic	0.616	0.286	-0.118	0.908	1.441
<i>p</i> -value	0.545	0.778	0.907	0.375	0.165

Panels A and B in Table 4 show that the magnitudes of CAARs of the ADRs were higher than those of corresponding equities on days one and two before the election. This could indicate that the equity prices at NSE in Mumbai could have been impacted to a higher degree by the news of the impending Parliamentary elections. However, the high *p*-values suggest that CAARs were equal to zero for the ADRs and for the equities prior to the election.

Table 5: Hypotheses Tests on Cumulative Average Abnormal Returns

Panel A; Trading Days After the election (data from National Stock Exchange, Mumbai)

INDIA	Day +1	Day+2	Day+3	Day+4	Day+5
CAAR	0.040	0.085	0.089	0.082	0.132
<i>t</i> -statistic	1.460	2.548	2.313	1.908	1.637
<i>p</i> -value	0.160	<b>0.019*</b>	<b>0.031*</b>	<b>0.070*</b>	<b>0.010*</b>

Panel B; Trading Days After the election (data from US Stock Exchanges, New York)

USA	Day +1	Day+2	Day+3	Day+4	Day+5
CAAR	0.028	0.047	0.053	0.046	0.065
<i>t</i> -statistic	1.277	1.744	1.713	1.322	1.716
<i>p</i> -value	0.216	<b>0.096*</b>	<b>0.100*</b>	0.200	<b>0.100*</b>

Results from Panels A & B in Table 5 show that the CAARs of equities and ADRs were positive starting from the first day to the fifth day after the election. The results of the election affected the higher values of CAARs after the elections, because the CAARs were much lower in magnitudes prior to the election. In general, CAAR values were lower for the ADRs than those for the underlying equities. The low *p*-values (indicated by bold asterisks) indicate that the CAARs were different from zero for the equities and the ADRs, on second, third and fifth day after the election. This would suggest that the news of the Parliamentary elections affected the CAARs on certain days after the election.

Table 6: Hypotheses Tests on Cumulative Average Abnormal Returns

Panel A; Different Windows (data from National Stock Exchange, Mumbai)

INDIA	W(+1,+3)	W(-1,+1)	W(-2,+2)	W(-3,+3)	W(-4,+4)
CAAR	0.073	0.018	0.065	0.090	0.097
<i>t</i> -statistic	2.185	0.545	1.507	1.781	1.689
<i>p</i> -value	<b>0.041*</b>	0.591	0.148	<b>0.090*</b>	0.106



Panel B; Different Windows (data from US Stock Exchanges, New York)

USA	W(+1,+3)	W(-1,+1)	W(-2,+2)	W(-3,+3)	W(-4,+4)
CAAR	0.028	0.016	0.029	0.024	0.052
<i>t</i> -statistic	1.045	0.612	0.849	0.595	1.123
<i>p</i> -value	0.308	0.547	0.406	0.585	0.274

It is observed from Panels A and B in Table 6 that the CAARs of the equities and the ADRs were positive during all the different time windows. The magnitudes of CAARs of the equities in NSE were higher compared to those of ADRs. The low *p*-values (marked with bold asterisks) indicate that the CAARs were different from zero for the equities in the four-day window [W(+1,+3)], and the six-day window [W(-3, +3)]. However, the higher *p*-values for the ADRs indicate that the CAARs were zero for all five different time windows considered in this study.

## 5. DISCUSSION

Results from this study show that the CAARs of the ADRs were lower in magnitudes than those of the underlying equities in NSE. The US stock markets usually are more efficient in disseminating political news. The news of the results of Indian Parliamentary elections quickly disseminated in the US stock exchanges than in NSE, which could result in the lower values of CAARs of the ADRs than CAARs of the underlying equities traded in NSE.

Sharma and Paul (2015) stated that high level of concentrated ownership in equities of family-owned businesses, limited access to debt and information asymmetry lead to inefficiencies in equity trading in developing markets such as India, Malaysia, and Brazil. Sharma & Paul (2015) further opined that with the advent of maturity in equity markets of the developing countries, asymmetry in information dissemination decrease and quality of information improve, while non-synchronous trading of the equities decreases with time.

Results from the current study indicate that the CAARs of Indian ADRs within two, four, six and eight trading day windows after the elections are lower than the CAARs of the underlying equities traded in NSE. This difference in the magnitudes of the CAARs between the ADRs and the underlying equities traded in NSE could be attributed to the difference in levels of efficiency between the US and the Indian stock markets, which had been discussed by Singh and Chakravarty (2017). The efficient dissipation of news from the results of the Parliamentary elections in India in US stock markets could impact the lower values of CAARs of ADRs. The values of the CAARs turned positive from two days prior to the election day to two days after the election, both for ADRs and underlying equities in NSE. This shows that the financial returns of the Indian ADRs and those of the underlying equities in NSE reacted positively to the Parliamentary election results in India in 2014.

Patel (2015) showed that Indian ADRs and underlying stocks in India positively affect each other's returns. Results from current work also corroborate this finding. The CAARs of ADRs and the CAARs of the same equities in NSE within two, four, six and eight-day windows after the elections were both positive and increased in magnitude, with the increase in the width of the short-term time windows,

## 6. CONCLUSIONS

The CAARs of equities and of the ADRs were higher in magnitudes on the first day after the election, compared to one day prior to the election. This shows that the results of the election impacted the CAARs. The CAAR values were lower for the ADRs, compared to those of the underlying equities traded in NSE. The results of the hypotheses tests indicate that the magnitudes of the CAARs were different from zero for the ADRs, and for the underlying equities traded in NSE on certain days after the Parliamentary election in India. This suggests that both the US and the Indian equity markets did not demonstrate semi-strong efficiency regarding the dissemination of the news about the Parliamentary elections in India

Results of this study have implications for portfolio managers, as well as for security regulatory authorities in India. First, this study suggests that the portfolio managers could select Indian ADRs with confidence, because news about significant political events in India would impact the financial returns of Indian ADRs positively. Second, security regulatory authorities in India could note that the cumulative abnormal returns of Indian ADRs are correlated with the cumulative abnormal returns of the underlying equities traded in National Stock Exchange of India. There is quick dissemination of important political news from India in the US financial markets. Hence, any negative news that affect the returns of the equities in India could also affect the returns of Indian ADRs. Based on this information, security authorities in India could implement proper steps to control any speculation in trades of the equities in Indian equity markets with ADRs also listed in US stock exchanges.

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