

New Product Launch and Stock Returns: Evidence from the Period of Demonetization in India

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Abstract

Period of demonetization has witnessed negative stock returns, and earnings growth rates across various industries in India. The average weekly return during this period on benchmark BSE Sensex was (0.42%), translating to an annualized return of (-20.34%). Using discounted cash flow (DCF) valuation formula, under the imperfect market conditions, new product innovations can create shareholders' value by affecting one of the two variables: (1) the future cash flows that are expected to be produced by the business; and (2) capital providers' required rate of return at which those cash flows are discounted by the market. A firm can beat the competition and increase its future cash flows by indulging in product innovation and launching such new products which are able to command higher prices in consumer market. New product innovations can also support the revival of products, which are on declining stages of their product life cycle, and in turn can reduce the uncertainty around the firm's cash flows. Reduction in the cash flow uncertainty results into lower required rate of returns by the capital providers. Consequently, new product launches can create shareholders' value, which can be captured by stock returns. The present paper uses cross section data for listed Indian firms to study investors' response to new product launches in the period of demonetization i.e., October –December 2016. To establish long term effect of new products launch on stock returns, a multivariate time series analysis is also conducted for single firm Maruti Suzuki for 26 quarters ending December 2016. Results suggest that new product launch has significant positive impact on quarterly EPS growth rate, and stock returns in long run as well as in short run. Also, in the crisis period of demonetization where all the firms across various industries have registered negative growth in EPS, and hugely negative stock returns, new product launch works as a savior for the firms.

Keyword: New Product Launch, Demonetization, Time Series Analysis, Stock Returns.

Acknowledgement: The Infrastructural support provided by FORE School of Management, New Delhi is gratefully appreciated.