Research in Accounting Regulation 27 (2015) 165–173

Contents lists available at ScienceDirect

Research in Accounting Regulation

journal homepage: www.elsevier.com/locate/racreg

Research Report

The effect of SEC approval of social media for information dissemination

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ARTICLE INFO

Article history:
Available online 26 September 2015

Keywords:
Regulation FD
Securities and Exchange Commission
Social media
Trading volume

ABSTRACT

In April 2013, the SEC provided explicit guidance to public companies regarding social media use for material disclosures. This paper examines the effect of regulatory approval on the market reaction to financial disclosures distributed by firms via social media. The use of social media to disseminate information may lead to broader market interest in the stock. Social media use by firms is explored in three time periods: (1) prior to public SEC scrutiny of social media, (2) after the SEC filed a formal complaint about the use of social media, and (3) after the April 2013 guidance. The analysis demonstrates a positive association between social media use and market reaction as evidenced in trading volume. Second, the association between social media use by firms and trading volume is greatest following the SEC's guidance. Third, social media are used more extensively by disclosing firms in the period following explicit SEC guidance permitting its use.

1 Introduction

This paper examines the effect of regulatory approval on the market reaction to financial disclosures made via social media. Social media are not generally used by firms as the primary disclosure channel, but rather to further disseminate information previously released through other methods (e.g., press release). More often than not, the social media release will provide only minimal information with a hypertext link to the earlier disclosure. The Securities and Exchange Commission (SEC) ruling on the use of social media for material disclosures[1] serves as a natural experiment with which to examine the assertion that regulatory approval of a given information channel increases the use of that information by investors.

Market reaction is assessed though an analysis of trading volume because it captures the breadth of market activity. The primary assertion is that use of social media to disseminate information leads to broader market interest and expands the base of investors for the stock. No new information is released to the market, and so, no revision to valuation is expected. That is, the use of social media is a way of advertising the equity, not necessarily to release new information.

In April 2013, the SEC provided explicit guidance to public companies regarding social media use for material disclosures. Social media use is explored in three time periods: (1) prior to public SEC scrutiny of social media, (2) after the SEC filed a formal complaint about the use of social media, and (3) after the April 2013 guidance. Empirical results suggest a positive association between social media use and market reaction, as evidenced in trading volume. Second, the association between social media use and trading volume is greatest in the period following the SEC's April 2013 guidance. This finding suggests that investors are more willing to accept and act on information where regulatory approval of the media channel exists. Investors may perceive the regulatory guidance as legitimizing social media. Third, social media use by firms is highest in the period following

Data availability: Data are publicly available from the sources identified herein.

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[1] To ensure exclusive capture of disclosures that are material in nature, "material disclosures" are operationalized as any financial disclosure. This is a conservative approach, likely to omit other types of material disclosures.

http://dx.doi.org/10.1016/j.racreg.2015.09.007
1052-0457/

explicit SEC guidance permitting its use. Thus the value proposition exists that corporations take the opportunity to expand the trading base for their shares through the use of the approved communication medium.

The remainder of the paper is organized as follows. The background, motivation, and research questions are discussed in Section 2. In Section 3 the data are described and the research design is presented. Results are presented in Section 4. Conclusions, limitations, and suggestions for future research are included as Section 5.

2 Background, motivation and research questions

Today's technology environment includes frequent introduction of new methods to communicate, such as social media. Over the past few years, social media usage has expanded, and organizations have used it in a variety of ways to connect with customers and other stakeholders. Recently companies began using social media to disseminate and bring attention to financial information. This use of social media was initially without regulatory guidance. In 2013, the SEC published guidance on how issuers may use social media to disseminate financial information. This study looks at the impact of the regulatory guidance on the trading volume of companies that use social media to disseminate financial information.[2]

This research is among the first to investigate the association between regulatory guidance and the use of social media for material disclosures as defined by the SEC, which regulates the full and fair disclosure of information that likely will be considered by an investor in making a financial decision:

> …the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions (Securities and Exchange Commission [SEC], 2013c).

Managers may use social media to disclose material information in a way that attempts to control the flow of information. Other traditional and well-established information channels exist for reporting material information, such as SEC filings and press releases. Some perceived incremental benefits are anticipated by management who include social media as a supplemental disclosure channel. Perceived benefits may be in the form of enhanced corporate image, increased sales activity, or additional public interest in the company. Thus, the use of social media to control the outward flow of information may be expected to benefit the company in explicit or even subtle ways that lead to broader interest in, and holdings of, the company's shares. From a capital markets perspective, the most important and largest consumers of material disclosures are institutional investors. As of 2010, institutional investors owned in excess of two-thirds of total market capitalization in the U.S., which represents an increase from below 10% in 1950 (Blume & Keim, 2012). In an April 19, 2013 speech, SEC Commissioner Luis Aguilar identified the systemic importance of institutional investors and the imperative for a proper regulatory climate:

> Institutional investors are known to improve price discovery, increase allocative efficiency, and promote management accountability. They aggregate the capital that businesses need to grow, and provide trading markets with liquidity – the lifeblood of our capital markets. In doing all this, institutional investors – like all investors – depend on the assurance of a level playing field, access to complete and reliable information, and the ability to exercise their rights as shareowners. That is why fair and intelligent regulation is necessary for the proper functioning of our capital markets (Aguilar, 2013).

Commissioner Aguilar makes it clear that the market benefits derived from the actions of institutional investors are, at least in part, predicated on the regulatory climate. An important implication of his statement is that the value of information transmission from managers to the public is inferior where regulatory guidance regarding the communication channel is lacking. Thus a proper regulatory climate is a necessary contextual condition for a social media value proposition to exist.

In April 2013, the SEC approved social media for corporate announcements that may have a material impact on an investor's interpretation of the financial information (SEC, 2013b). The caveat to the SEC's guidance is the public must be alerted that the company intends to report material information through social media. The SEC's announcement was, at least in part, a result of Netflix's CEO using his personal Facebook account to report material information about Netflix. On December 5, 2012, the SEC issued a Wells notice to Netflix and the CEO asserting that Regulation Fair Disclosure (FD) had been violated.[3] A Wells notice is a letter issued by the SEC to notify parties that it intends to bring an enforcement action (SEC, 2013d, pp. 22–25). Recipients of a Wells notice have discretion in whether or how to inform the public. Prior to the Netflix Wells notice, the SEC had not explicitly commented about the use of social media as a means of disclosure.

Commissioner Aguilar's call for research regarding the impact of SEC regulation on the markets begs the importance of empirical analysis of the impact of the April 2013 social media disclosure guidance. An underpinning of the integrity of the capital markets is that the public has confidence about the reliability of material disclosures. Thus the tone of the regulatory climate (i.e., SEC guidance) is important when considering the method of disclosure and the

[2] Schaupp and Bélanger (2014) define social media use in a business context as the deployment of a network to develop a community of users who collectively create, know, like, and trust relevant matters of the business entity. Social media are those networks, such as Facebook, Twitter, LinkedIn, or Pinterest, where virtual communities are established and maintained. These popular social media platforms are not an exclusive list of social media outlets. In fact, any website or network that invites the public to interact with others falls into the broad definition of social media.

[3] On December 5, 2012, Netflix, Inc. filed Form 8-K to disclose receipt of the Wells notice (SEC, 2012).