



Contents lists available at ScienceDirect

International Review of Financial Analysis

journal homepage: www.elsevier.com/locate/irfaRumor rationales: The impact of message justification on article credibility[☆]

Sandra Betton, Frederick Davis*, Thomas Walker

John Molson School of Business, Concordia University, Montreal, Canada

ARTICLE INFO

JEL classifications:

G14
G34
G30

Keywords:

Mergers and acquisitions
Takeover rumors
Trading strategies
Financial content analysis
Market anticipation
Takeover predictability

ABSTRACT

We perform content analysis on a unique sample of 2074 first-instance published takeover rumors to study how the rationale underlying a publication relates to its credibility and its association with firm returns and rumor accuracy. While most takeover rumors are inaccurate, we find that distinguishing between various justifications of potential takeover activity as provided within the published article serves to predict takeover announcements, subsequent firm abnormal returns, and – to a lesser extent – premiums. In addition, we note a clear distinction in results based upon the informative versus speculative nature of the rumor. We interpret this evidence as supportive of our hypothesis that the underlying rationale justifying the release of public information affects firm share prices and aids in predictability.

“News stories rarely have a simple, predictable effect on the market.”

Shiller (2005)

Public news announcements are a major mechanism for disseminating information to investors, allowing them to estimate firm values (Engelberg & Parsons, 2011; Griffin, Hirschey, & Kelly, 2011; Tetlock, 2010). Dougal, Engelberg, Garcia, and Parsons (2012) and Peress (2014) report a market-wide impact of the media, while Ryan and Taffler (2004) find that corporate news events drive a significant proportion of economically significant price changes in the 350 largest firms on the London Stock Exchange. Despite the importance of the financial media, relatively few papers explore in detail how investors interpret descriptive information and whether they efficiently incorporate that information into prices, primarily due to the difficulty in objectively quantifying such information (Jegadeesh & Wu, 2013).

This article performs a rigorous content analysis of public news announcements in the context of takeover rumors. In particular, we quantify how the market responds to takeover rumors which are categorized according to the article's motivation; i.e. the underlying rationale(s) justifying the article's publication as provided in the initial (‘scoop’) news source. We further identify which of these rumor justifications are ultimately proven to be most accurate, in that the rumored target firm becomes subject to a formal takeover announcement within one year. Such rumors represent an appropriate setting to examine the

underlying arguments upon which public information is based, as mergers and acquisitions impact a wide range of stakeholders and are among the biggest investment decisions a company ever makes (Luo, 2005); furthermore, takeovers on average result in offer premiums of over 46% (Betton, Eckbo, & Thorburn, 2009), with related rumors substantially responsible for price runups before a bid is formally announced (Betton, Eckbo, Thompson, & Thorburn, 2014).

Not all rumors in the business press provide similar information upon which investors can base their decisions. To illustrate, compare two unrelated articles, the first appearing in the New York Times on January 21, 2008, entitled “Getty Images up for Sale, Could Fetch \$1.5 Billion” which read: “Getty Images ... has put itself on the auction block and could fetch more than \$1.5 billion, people briefed on the situation said Sunday. The firm hired Goldman Sachs to advise it on a potential sale, these people said. The company has attracted interest from several buyers, mostly private equity firms, including Kohlberg Kravis Roberts, Bain Capital and others ... A spokeswoman for the company contacted last week said the company does not comment on ‘rumors and speculation’.” The second article, appearing in the Dow Jones Newswires on February 19, 2010, entitled “Options Report: Traders Quick to Respond to Buyout Rumors” noted that: “Options traders proved willing to respond to several buyout rumors Friday... In Myriad Genetics, traders picked up 3000 calls and just 300 puts, taking particular interest in the company's March \$24 calls. Those contracts are priced at \$0.45 and make money if Myriad Genetics rises above \$24.45. The stock recently

[☆] The authors would like to thank the Fonds Quebecois de la Recherche sur la Societe et la Culture (2015-NP-182891), the Social Sciences and Humanities Research Council of Canada (430-2013-0502), as well as Concordia University (2012-VS1133) (seed funding program) for the funding of this research.

* Corresponding author.

E-mail address: frederick.davis@concordia.ca (F. Davis).

<https://doi.org/10.1016/j.irfa.2018.03.013>

Received 6 October 2017; Received in revised form 15 March 2018; Accepted 25 March 2018
1057-5219/ © 2018 Elsevier Inc. All rights reserved.

traded for \$22.30, gaining 3.3%.”

Rather than treating these takeover rumors as having equivalent investor outcomes, we code each rumor according to textual elements which relate to the underlying rationale for the rumor's existence. In the first article, the rumor article indicates an insider was cited, a financial advisor was hired, and private equity funds have expressed interest in the target firm. In the second article, the rationale for the rumor includes an increase in the number of call options placed on the target firm as well as unspecified pre-existing takeover chatter. We hypothesize that the nature of public information may differ in its immediate credibility and in its ultimate accuracy depending upon the underlying rationales justifying the rumor's publication. The coding of such rumor justifications provides in-depth clarification on the informativeness of publicly available signals and forms the basis for much of our empirical analysis.

We construct the largest database of first-instance takeover rumor articles to date, manually searching Capital IQ, Factiva, ProQuest, Standard & Poor's Takeover Talk, and Zephyr to ultimately identify 2074 “scoop” articles which first report a takeover rumor of a firm listed in the Center for Research in Security Prices (CRSP) database between 2002 and 2011. Once a takeover rumor is found that clearly identifies a target firm, we search backwards to ensure that a clean window of at least 180 days exists without similar rumors. We categorize rumors according to sixteen non-mutually exclusive takeover rationales as provided in the article text and note whether the rumor was denied by either the target firm, potential bidder, or both. We exclude rumors in which either the rumored bidder or target confirms that negotiations are underway to preserve a clear distinction between rumors and takeover announcements. We use the Thomson Reuters SDC Platinum database as the source of takeover announcement dates, but because results are heavily reliant on the existence and timing of such announcements, and SDC data accuracy has been heavily criticized (Barnes, Harp, & Oler, 2014; Bharadwaj & Shivdasani, 2003; Faccio & Masulis, 2005; Mulherin & Simsir, 2015), we conduct a manual search of both Factiva and Google to correct for announcement date errors and omissions.

Through the use of takeover rumors, we investigate three main questions. First, which media article characteristics predict whether a rumor comes true? Second, do investors account for the characteristics that predict accuracy and which relate to future returns? Third, can investors combine signals available on the rumor date to predict outcomes? While our results arise from an analysis of takeover rumors, the benefits of analyzing article justifications and combined signals could be seen to apply to publicly available information in general.

To address our first question on the determinants of accuracy, we estimate a series of logit regressions of the likelihood that a rumor comes true on rumor content, with extensive controls for variables previously found to predict takeovers. These control variables include multiple proxies for managerial motivation to pursue a deal, target newsworthiness, abnormal returns surrounding the rumor date, and year, industry, and news article fixed effects.

To address our second question relating investor behavior to future outcomes, we first test whether the magnitude of the market's immediate response to a rumor predicts its accuracy. We then provide multivariate analysis of both rumored target firm and rumored bidding firm cumulative abnormal returns (CARs) surrounding the rumor date period. Furthermore, we construct long-short portfolios based on either the predicted accuracy of rumor characteristics or on a combination of rumor characteristics as available over the rumor date period.

To address our third question, we create two mutually exclusive categories of rumors based on the degree to which the rumor justification exhibits a demonstrable link to future takeover activity. In particular, we label as *Speculative* those rumors based solely on either takeover chatter or an increase in option activity in the target firm, with no further justification provided. Such rumors are often found in news sources such as Benzinga, The Fly on the Wall, or Street Insider, among

others. We label as *Informative* those rumors based on at least three rumor justifications, excluding those labelled as speculative, hypothesizing that multiple takeover signal motivations will provide a stronger effect than one alone. This is similar in spirit to Kosfeld (2005, pp. 659) who asserts that “intensifying the communication increases the probability for agents to eventually believe in the rumour” and to Purnanandam and Seyhun (2018) who show that by following joint signals, there are significant gains in trading returns as compared to returns from trading strategies that only follow individual signals.¹ In essence, we create two simple and intuitive proxies of rumor credibility which are available to investors on the initial rumor date, and test for their relationship to accuracy and share price abnormal returns via a series of logistic and multivariate analyses.

A number of interesting results emerge from our investigation. First, we find that there are various rumor rationales which are significantly positive predictors of future takeover announcements and that are associated with significant rumored firm abnormal returns prior to, on, and after the rumor date. For example, takeover rumors citing the potential for unique synergetic benefits are predictive of takeover announcements and result in significantly positive pre-rumor date *bidder* firm returns, while takeover rumors based on target firm distress result in significantly negative rumor date target firm returns (and significantly positive rumor date *bidder* firm returns). These and other findings suggest that all takeover rumors should not be treated equally, as the literature often implicitly assumes, and in particular that the underlying justification for the rumor article has merit and deserves attention.

Second, we find that the magnitude of the market's response to the average rumor predicts the rumor's accuracy, but not fully. Many rumor characteristics remain significantly related to accuracy after controlling for the stock market's response, while the average target of a rumor experiences an abnormal return reversal, i.e. a rumor date overreaction, following the rumor publication. Surprisingly, rumor date *underreaction* also exists, particularly for rumors based on industry activity or for rumors citing the potential for unique synergetic benefits.

Third, not all takeover announcements are considered good news for target firms around the announcement date, and factors which predict takeover announcements in general are not identical to those which predict takeover announcements beneficial to target firms.² In particular, rumor date runup abnormal returns, $CAR(-5, -1)$, as well as rumors in which the target denies that takeover negotiations are underway, *TargetDenied*, are significant predictors of beneficial takeover announcements but not takeover announcements in general. This suggests that some investors have access to information contained within the initial rumor article shortly prior to its release, and can distinguish the share price effect this will have on the target firm.

Fourth, we find that *Informative* (*Speculative*) rumor rationales are significantly positive (negative) predictors of impending takeover announcements, and are significantly positively (negatively) related to rumor date target firm returns. These findings suggest that the degree to which the rumor is demonstrably linked to future takeover activity is important; in particular, rumors providing multiple signals of explained linkages (i.e. informative rumors) are not only more accurate than those providing vague linkages (i.e. speculative rumors), but are also deemed to be more credible on the rumor date, and more likely to result in abnormal return continuations than reversals over the post-rumor period. Additionally, an equally-weighted portfolio which is long on target firms subject to *Informative* rumors and short on target firms subject to *Speculative* rumors provides 1.09% monthly returns over the one-year post-rumor period, significant at the 1% level. Similarly, an

¹ In fact, composite signals are commonly employed in finance, such as Altman's (1968) Z Score or Gompers, Ishii, and Metrick (2003) Corporate Governance Index.

² As defined by providing a positive cumulative abnormal return to the target firm over the $(-41, +1)$ takeover announcement period.

Download English Version:

<https://daneshyari.com/en/article/7355637>

Download Persian Version:

<https://daneshyari.com/article/7355637>

[Daneshyari.com](https://daneshyari.com)