Company Name Influences Stock Performance

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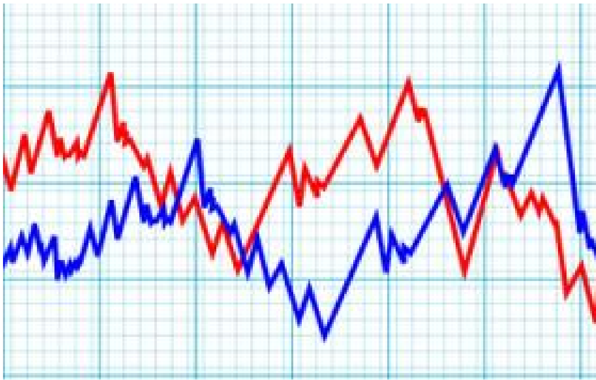

According to researchers at Princeton University, companies with easily pronounced names and stock ticker symbols perform better in stock markets in the days following the initial public offering (IPO). Credit: Nicolle Rager, National Science Foundation

The ease of pronouncing the name of a company and its stock ticker symbol influences how well that stock performs in the days immediately after its initial public offering, two Princeton University psychologists have found.

A new study of initial public offerings (IPOs) on two major American stock exchanges shows that people are more likely to purchase newly offered stocks that have easily pronounced names than those that do not, according to Princeton's Adam Alter and Danny Oppenheimer. The effect extends to the ease with which the stock's ticker code, generally a

few letters long, can be pronounced -- indicating that, all else being equal, a stock with the symbol BAL should outperform one with the symbol BDL in the first few days of trading.

"This research shows that people take mental shortcuts, even when it comes to their investments, when it would seem that they would want to be most rational," said Oppenheimer, an assistant professor of psychology. "These findings contribute to the notion that psychology has a great deal to contribute to economic theory."

Oppenheimer and Alter, a graduate student in Oppenheimer's lab and the study's lead author, will publish their work in the May 30 issue of the journal, *Proceedings of the National Academy of Sciences*.

The two researchers were initially looking for a different effect when they stumbled upon the relationship between ease of pronounceability and performance. They asked a group of students to estimate how well a series of fabricated stocks would perform based only on the stocks' names.

"We gave them the list of company names and essentially asked, 'How well do you think the stock would perform?'" Oppenheimer said. "At the time, we were primarily interested in studying whether we could manipulate how people interpret the feeling that information is easy to process. We weren't trying to study markets or companies initially; stocks were just an interesting domain of inquiry."

However, the relationship was very strong -- regardless of Alter and Oppenheimer's attempts to manipulate students' interpretations, the students still believed that the easily pronounceable stocks would perform best.

When they noticed how strongly name pronounceability influenced

predictions of performance, the researchers moved beyond the lab and investigated the relationship between the variables in two large U.S. stock markets -- the New York Stock Exchange and the American Exchange. The effect held in the real world: the more "fluent" a stock's name or symbol, the more likely the stock was to perform well initially.

"We looked at intervals of a day, a week, six months and a year after IPO," Alter said. "The effect was strongest shortly after IPO. For example, if you started with $1,000 and invested it in companies with the 10 most fluent names, you would earn $333 more than you would have had you invested in the 10 with the least fluent."

Alter said the pair of scientists had been careful to address the possibility that other factors were at play in the study.

"We thought it was possible that larger companies might both adopt more fluent names and attract greater investment than smaller companies," he said. "But the effect held regardless of company size. We also showed that the effect held when we controlled for the influence of industry, country of origin and other factors."

Oppenheimer cautioned that while the findings might seem highly significant to the investing public, they do not tell the whole story about how a stock might perform after its IPO, nor are they reliable indicators of its performance in the long run.

“Despite the implications of these findings, investors as a group tend to correct themselves in the presence of new information about how the markets operate," he said. "You shouldn't make changes to your stock portfolio based on our findings. The primary contribution of this paper is to add a piece to the jigsaw of understanding how markets operate.”

What the findings did offer, Oppenheimer said, was another piece of

evidence that markets -- and therefore the large groups of people who invest in them -- are not the rationally-functioning entities that some experts believe them to be.

"This is not the only factor that plays a role in stock performance," he said. "A number of other economic and psychological factors undoubtedly play a role as well. This study does not argue that psychology is more important than economics, but rather that one cannot ignore psychological variables when constructing models of stock performance."

Source: Princeton University

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