Firms use media coverage to influence merger negotiations

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(PhysOrg.com) -- Companies involved in merger talks manipulate their stock prices during negotiations by releasing more news than usual, according to a University of Michigan study.

"Media coverage has a significant effect on stock trading and returns," said Kenneth Ahern, assistant professor of finance at U-M's Ross School of Business. "Even stale news, if widely publicized, can dramatically raise short-term returns and influence prices of large and widely followed stocks in the S&P 500."

In their study, "Who Writes the News? Corporate Press Releases during Merger Negotiations," Ahern and Ross School colleague Denis Sosyura examined more than 500 completed stock mergers of large U.S. publicly traded firms from 2000 to 2008. They studied the frequency and content of news releases issued by acquiring firms, and analyzed more than 617,000 articles in 421 newspapers and newswires worldwide.

"We find that bidders in stock mergers originate substantially more news stories after the start of merger negotiations, but before the public announcement," said Sosyura, assistant professor of finance at the Ross School. "This strategy generates a short-lived run-up in bidders' stock prices precisely during the period when the stock-exchange ratio is determined, which leads to a lower takeover price."

The researchers provide strong evidence that firms manage their media through news releases precisely when they would benefit the most from

a temporary price increase.

For fixed-exchange-ratio stock mergers (when the target and acquiring firm negotiate a fixed number of acquirer shares as payment for target stock), this occurs during the negotiation period from the time that talks first begin until before the public announcement of the merger. In contrast, in floating-exchange-ratio stock mergers (where the exchange ratio is determined at the close of the merger) there is no increase in firm-originated news during the negotiations.

Fixed-ratio acquirers issue nine extra news releases during the average negotiation period (about 64 days), a 10 percent increase compared to baseline averages, and have an increase of 2.3 more articles per day compared to floating-ratio acquirers, the study shows. Further, domestic news coverage is 50 percent higher and newswire coverage is 85 percent higher for fixed-ratio bidders during the negotiation period compared to the pre-negotiation period (the 120 trading days prior to the beginning of merger talks).

"The marked increase in media coverage has a significant and positive effect on stock returns consistent with the evidence that higher visibility induces short-term demand for a stock," Sosyura said. "Furthermore, consistent with active media management, we observe a drastic correction in the stock prices of fixed-ratio bidders after the merger announcement."

Over the three-day period around the merger announcement, an average fixed-ratio bidder loses about 4.1 percent in market value, compared to only 2.5 percent for floating-ratio acquirers, the researchers say. This downward trend continues over the following two months, with fixed-ratio bidders losing nearly 40 percent of the negotiation-period abnormal stock price run-up.

Ahern and Sosyura found that compared to floating-ratio bidders, fixed-ratio bidders issue significantly fewer negative news releases during the period when the exchange ratio is established. Also, newspapers are less likely to report on news releases issued by fixed-ratio acquirers during merger negotiations compared to floating-ratio acquirers.

"The evidence suggests that the changes in the number and tone of the acquirer-originated press releases reflect active media management rather than random arrival of good news," Ahern said. "In contrast to the view that the information contained in media reports increases the efficiency of a market, we show that the press can be strategically used by firms to advance their own interests.

"The strategic use of media by firms is likely to affect many corporate actions beyond mergers, such as executive compensation, stock issues and repurchases, proxy contests and product market competition."

Provided by University of Michigan

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