

Study explains how firms should handle bad news

October 3 2013, by Matt Weeks

(Phys.org) —When a firm becomes the subject of a news story its stock price is usually affected. Whether positive or negative, newly publicized details about a company tend to attract investor attention and move the stock price based on the article's sentiment.

In the past, managers have been hard-pressed to respond appropriately. But new research from the University of Georgia Terry College of Business and published in the *Journal of Marketing Research* shows that two in-house tools can influence the effects of news reports on [stock price](#).

The article examined 141 [firms](#) over about five years, finding that when news reports highlighted positive news, firms with higher advertising levels experience stronger increase in their stock prices. When negative articles are published, however, advertising doesn't mitigate the dysfunctional effects. In those instances, firms with strong marketing capability can better calm customer and investor fears.

"People have talked about the fact that investors tend to buy better known stocks, but nobody really talks about how that link happens," said Sundar Bharadwaj, co-author of the paper and Coca-Cola Company Chair Professor of Marketing at UGA. "What we are able to show is that the way advertising operates is by increasing individual investors' attention and interest in the stock. We show that when there's good news and the company advertises that good news, we find that Google searches for the ticker symbol of the company go up, but not for the

[company](#) name. Unlike a big institutional buyer who is well aware of the symbol, it's the individual buyer who searches for ticker symbol. So we can see that, all of the sudden, a lot more people are buying the stock."

Bharadwaj, who co-authored the paper with fellow UGA marketing professor Guiyang Xiong, added that when negative news breaks about a firm, advertising does not help, but marketing capability can soften the detrimental impact of such news on [stock price](#).

"In the article, we cite an example of a story about McDonald's charging minority customers more than others. They immediately took action and put out news on Twitter and other online forums to assure people right off the bat that this was just a rumor that it was untrue, and it just squashed the rumor," Xiong said. "If they had not done that, the rumor could have cost the firm quite a bit of money. And they knew where to reach the key influencers in their customer base because of the strong marketing capability that they had built."

Marketing capability refers to a firm's capacity to understand consumers' needs and influencers. When companies invest in understanding their customers-through good customer relationships, monitoring clients' environments, a high quality sales force, etc.-they develop the ability to generate positive outcomes. A firm with strong marketing capability can better predict customer reactions and quickly react appropriately to negative news.

Because marketing capability is difficult to make visible to outside investors, it is often undervalued. The UGA study, however, finds that insider investors understand the value of marketing capability and tend to buy more stock following a news release.

"Our contention is that if you have strong marketing capability it's important for you to let outsider investors also benefit," Bharadwaj said.

"We are saying that as firms are using advertising to promote good news, they should also tell investors that they have strong marketing capabilities that can help them mitigate negative news so that instead of dumping the stock, investors will end up buying more of it. Firms should use things such as investor forums to reassure current [investors](#) and explain their abilities, while at the same time ensuring that their competitive advantages are not revealed."

Provided by University of Georgia

Citation: Study explains how firms should handle bad news (2013, October 3) retrieved 20 March 2024 from <https://phys.org/news/2013-10-firms-bad-news.html>

<p>This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.</p>
--