Stock market fails to predict product performance

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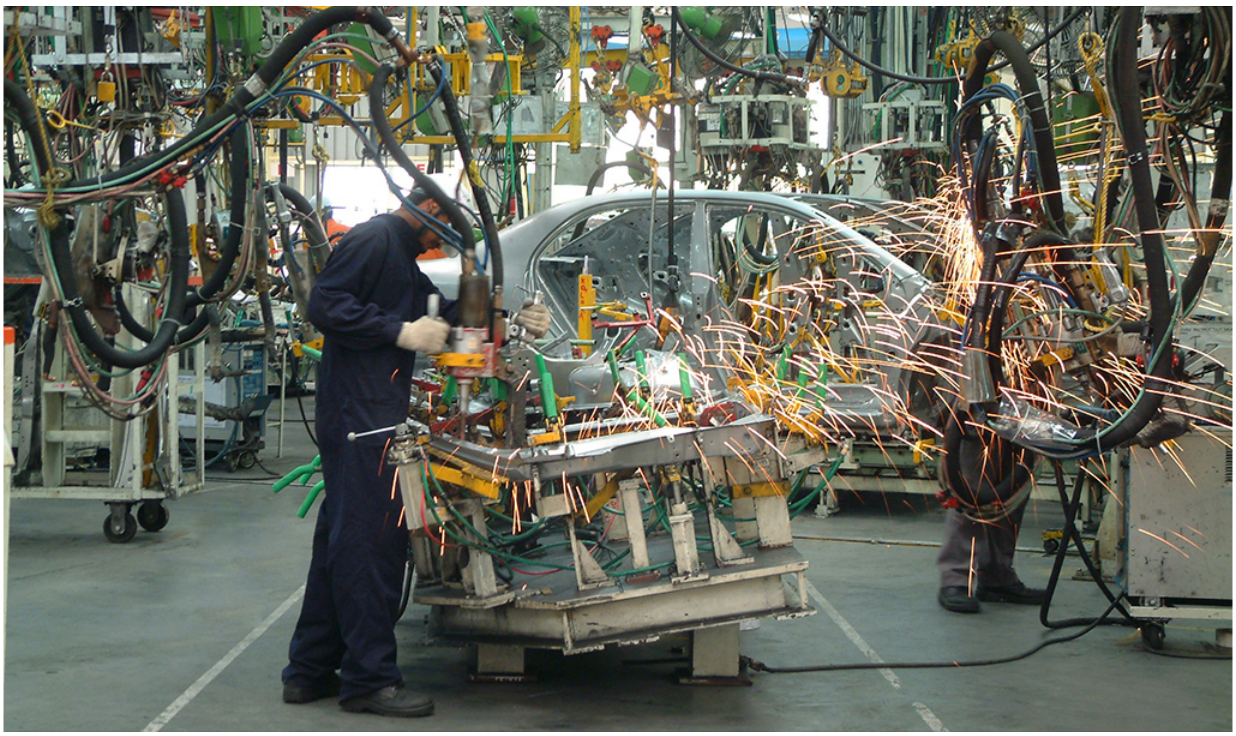

Credit: Michigan State University

Contrary to what many in the business world believe, investors cannot reliably predict how a new product will perform, finds a new study co-authored by a Michigan State University marketing expert.

The research examined short-term market returns, or investor reactions, following the preannouncements of 208 vehicles in the U.S. auto industry between 2001 and 2014. Turns out, investors predicted a product's future performance successfully only 48 percent to 55 percent of the time.

"When a new product is preannounced, the short-term reaction of the stock market is unreliable," said Ahmet H. Kirca, associate professor of marketing in MSU's Broad College of Business. "It's really a flip of a coin."

Consider the Chevrolet SSR, a retro-style pickup truck with a hardtop retractable roof. Following the preannouncement of the SSR in 2003, the market reaction was positive, boosting the value of parent company General Motors, yet SSR sales never took off and the model was discontinued after three years.

On the other hand, the Ridgeline—the only pickup Honda offers in the highly competitive U.S. truck market—has survived since its preannouncement in 2005, despite investors' initial negative reaction.

The findings may be applicable to other industries, such as information technology and pharmaceuticals, that rely on preannouncements to spread the word about upcoming products. As an example, Apple's stock dipped by 6.7 percent in three days after the preannouncement of the first-generation iPad, but the product went on to become wildly successful.

Kirca said there is a fundamental assumption among many marketing researchers and business officials that investors can immediately gauge how a marketing action such as a product preannouncement will affect company value and future product performance.

"Our findings challenge that fundamental assumption," he said.

The study did find, however, that short-term market reactions to preannouncements can reliably predict product performance under certain circumstances. Those include preannouncements:

- That are more detailed and truthful.
- That are made in product categories with fewer competitors
- That are used with advertising.
- That are made in product categories with high brand reputation.
- That are about incremental innovations (as opposed to radical product innovations).

When it came to preannouncements of new vehicles that were incrementally improved, for example, stock market returns predicted product performance with much higher accuracy (89 percent of the time) than those that involved radical innovations (only 50 percent of the time).

"Given that companies use short-term stock market reactions as a surrogate for decision making and budget allocation purposes," Kirca said, "our findings caution managers against the use of these market reactions as a sole yardstick to assess future performance of product preannouncements with highly uncertain outcomes."

"Instead," he added, "company managers should use investor reactions to preannouncements as a gauge for future performance only under specific conditions."

Provided by Michigan State University