

THE PR PREMIUM

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Abstract

The Researched Issue

Publicly traded companies are required to disclose material information affecting the value of the security. There is a demand for the firm's disclosure due to the information asymmetry between firm's management and investors. Firms employ various means to disclose their performance and activities. (e.g.: conference calls and presentations to analysts). The most popular and common mean of disclosure is a Press Release (PR). PR is either written or recorded announcement given to members of the news media for the purpose of announcing the public claimed informative news.

PRs appear in the firms' web sites under the Investor Relations section and are distributed via commercial press release distribution services such as PR Newswire and PR NewsChannel and Business Wire. These distribution agencies distribute PR to many common financial sites such as finance.yahoo.com, www.google.com/finance, to name a few. During recent years, the internet platform has become the main communication channel between firms and market participants. The internet is apparently the perfect platform to address the Regulation Fair Disclosure (Reg. FD) requirement, as the Reg. FD mandates the publicly traded companies to disclose all material information simultaneously to all investors.

PRs usually have a structured form. They start (or finish) with a brief description of the company that usually contains some sort of self praises such as: "*... is a global provider of advanced solutions*", "*the world's leading provider of...*", "*... is the global distributor of*" or "*... is the innovative technology leader*". The readers are exposed to these marketing tidbits whenever reading PR issued by the firm thus one may associate the firm and its self praises.

In this research, the term PR Volume refers to the counted number of published press releases for each firm per annum in the firm web site. This number varies substantially among firms from just a few to hundreds per year. My suggestion is that in addition to the informative value of the PR, it may also be an attempt to boost the firm in public awareness and affect its trading. Therefore, my goal is to document the effect of annual PR volume on stock returns. The research hypothesis is:

H1: The stocks of firms that publish high annual PR volume yield lower annual returns than the stocks of firms with low annual PR volume.

My research proved that firms with high PR activity have lower annual return than firms with lower activity. This is consistently significant and was between four to six percent in my research.

Analysis

In this research, I classified the firms according to their annual number of published PR. The firms were then ordered from low to high. I named the first third Low Press Release (LPR) and the last third High Press Release (HPR); firms in the middle third were omitted from the sample to achieve a two-group test. This classification includes certain normalization to PR activity. For each firm in each group various parameters are gathered and calculated including, among others, risk and return. I used univariate analysis and multivariate analysis to analyze the data. The univariate analysis was mainly descriptive statistics to compare various characteristics between the two groups. The multivariate analysis used was OLS regressions in order to isolate the PR annual volume influence on return, beyond the risk influence, taking into account necessary controls such as: firm's Equity Market Capitalization, Book to Market ratio, Financial Leverage, Media Coverage, Liquidity and more.

My sample consists of 498 firms over 1,393 firm years. The firms belong to the technology sector and were traded at NASDAQ (80%) or NYSE (20%) between 2001 and 2007.

Main Results

I have found, using several risk proxies, that HPR firms have higher risk than LPR firms. In light of the known tradeoff between risk and return the risky group, namely the HPR, should yield higher returns. However, the actual results were opposite. The HPR groups yielded lower returns than the LPR groups and the differences were significant. In order to quantify this gap, I employed some OLS regressions with return as explained variable, taking into account risk and other factors. The main results showed that the average annual return of the LPR firms is higher than the average annual return of HPR firms by 4% to 5.7% for the PR_Year +1 (PR_Year is the year in which the PR were published and counted) and 7% to 8% per annum for the PR_Year. I call this gap in returns "The PR Premium". These findings are consistent using many regressions' specifications and prove the research hypothesis.

In addition, the analysis showed that the average daily trading volume of HPR firms is three times higher than with LPR firms. Both the willingness of investors to be compensated with lower returns and their still popular purchase might be due to the firm's perceived quality, a possible side effect (intentional or not) of high PR volume. This further illustrates the general impact PR volume has on steering the investors' interest, and supports the notion that perceived company image can bias financial trading activity.

Contribution of this Research

The findings can be explained by using the behavioral finance theory, which explains, among others, why market participants make systematic errors creating market inefficiencies. PR Premium is an excellent example for such a systematic error.

A common conception, in many empirical studies, is that disclosure, with emphasis on quality, is better for the investors as it reduces the information asymmetry between managers and investors. I chose to research PR as it is the biggest and most popular vehicle of disclosing information to the public, thus PR volume is a proxy for disclosure level. Focusing specifically on PR volume comes with some oversimplification - the number in itself is not qualitative, nor deals with informative

content – albeit giving coherent results that further explain disclosure impact on financial decisions.

My hypothesis challenges the classic principle of the better the disclosure level the lower the cost of equity capital. My findings did show that high PR volume lowers cost of capital, however being that I sorted the firms by quantity, I could still assess disclosure impact. The classification into groups based on this number enables us to fully interpret the magnitude of this variable coefficient. Therefore, I proved that the impact of disclosure increases by its sheer volume and is measureable without going into the controversial evaluation of PR content quality. Moreover, my results are unconditional and consistent across the board and can be applied as a usable tool for PR impact analysis. My findings can help, say, a firm's PR policy maker as the PR volume is subject to his control, or investors assessing a stock before buying.