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HÁSKÓLI ÍSLANDS

The effect of media coverage on IPOs

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In 2003, the OMX15 index on the Icelandic Stock Exchange increased by 56% and during the first two weeks of 2004 it had already jumped by 6%. Only in Russia, Lithuania and Turkey did investors get a higher return that year (“Rökrétt bjartsýni?”, 2004). And this was only a taste of things to come.

During a four year period, from January 5th, 2004, to January 3rd, 2008, the OMX15 index increased from 2,102 points to 6,144 points. When the three largest Icelandic banks; Landsbanki, Kaupþing and Glitnir, collapsed in October, 2008, it was hard to believe that only 15 months earlier, on July 18th, 2007, the stock exchange index had peaked at 9,016 points. (Figure 1 shows the development of the OMXIPI from the beginning of 1998 to the fall of 2008).

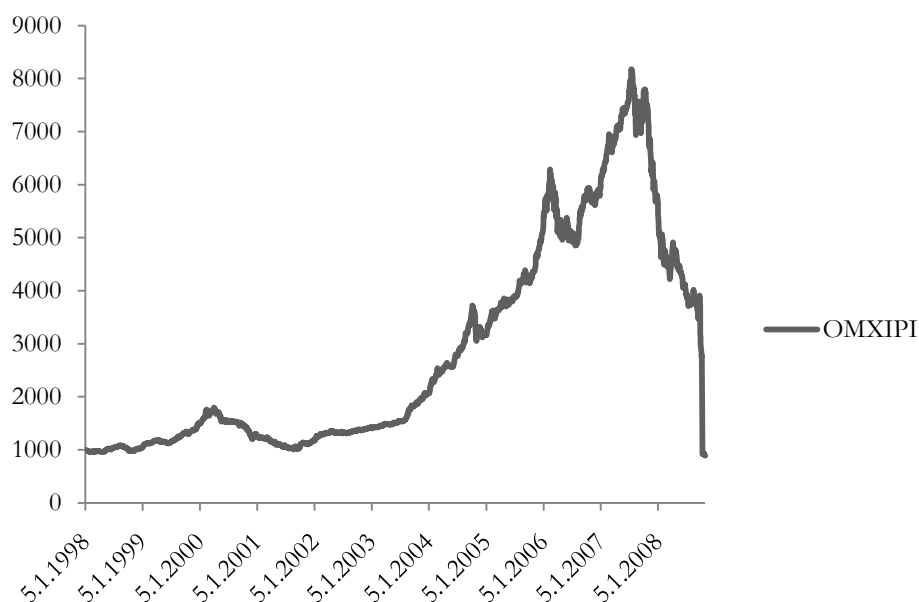


Figure 1. The development of the OMXIPI index 1998 – 2008 (Source: Nasdaq OMX Nordic in Iceland).

For years, the stock market in Iceland was relatively unknown to the general public. In the advent of the Internet bubble, however, there was a heightened interest in stocks, and from 1998 to 2000 the general media started covering the stock market to a greater extent. In 2000, for example, the news magazine show *Kastljós* invited two stock analysts every other week to make buy recommendations (Magnúsdóttir, 2004).

Theories of *agenda setting* and *framing* within the mass communication literature explain how the media have been able to draw people's attention to the stock market and generate interest in stocks. By solely covering a particular topic, the media raise that subject's importance in the eyes of their readers/viewers/listeners. Studies have

¹ This pilot project was conducted in co-operation with Guðbjörg Marteinsdóttir and Atli Gylfason.

repeatedly found a relationship between what topics make it to the media's agenda and how much weight the public puts on those same topics. The more attention the media pay a particular subject, the more important the public believes that topic to be (McCombs & Reynolds, 2009).

Furthermore, the media have the ability to influence people's attitudes towards subjects by portraying them in a positive or a negative light (Tewksbury & Scheufele, 2009). Thus, in the last decade, the media not only drew people's attention to firms and their listing on the stock market by covering them but the media may also have given the public the impression that the ownership of stocks was preferable, and in particular, that owning stocks in certain firms was desirable.

After the stock market crash in the fall of 2008, the Icelandic media have been harshly criticized for being cheerleaders of the stock market and for failing to offer their users a neutral and critical analysis of companies. Moreover, it seemed that the media hyped interest in Initial Public Offerings (IPOs).

The present paper will attempt to investigate whether there was in fact a relationship between the media coverage of IPOs from 1998 to 2008 and their abnormal return.

Media coverage and IPOs

So far, researchers have paid surprisingly little attention to the effects of media on the stock market and how media coverage prior to the initial public offering may influence the prices of IPOs. This lack of interest among the scientific community may in part be due to the fact that such studies combine two, seemingly very different, disciplines, i.e. mass communication and finance.

Nevertheless, a few studies have already been conducted in this area. The Internet bubble of the late 1990s was the inspiration for studies by DuCharme, Rajgopal and Sefcik (2001a, 2001b), Demers and Lewellen (2003) and Bhattacharya, Galpin, Ray and Yu (2004). The Internet bubble reflected the now-known-to-be unfounded expectations of investors toward technology firms. The initial returns of Internet firms were often quite high. For example, in 1999, StarMedia Network's starting price was \$15. By the end of the first trading day it was \$26. A year and a half later it was \$1.89 per share (Bhattacharya et al., 2004).

In their studies, DuCharme and colleagues (2001a, 2001b) examined 227 Internet firms that went public from 1988 to 1999 in the United States and media exposure of those firms seven days prior to the IPO date. As might have been expected, 166 of those firms went public in 1999. DuCharme et al. operationalized media exposure as the number of times a firm was mentioned in the popular press and the electronic media, based on the Lexis/Nexis database.

They came to the conclusion that Internet firms were greatly underpriced, i.e. there was a run-up in stock price during the first day of trading. On average, the stock price of the Internet IPOs increased almost 75% from the time of the issue until the market closed for the day on the first day. In general, underpricing of IPOs has been found to be on average 14%. Moreover, television and radio coverage of the Internet firms seven days before the IPO predicted underpricing. More media coverage meant more underpricing. They suggest that „media hype may have caused some of the substantial underpricing in the Internet IPO market,“ (DuCharme et al., 2001a, p. 4). More importantly, the media coverage of Internet firms was three times higher than the media coverage of non-Internet firms.

The study by Demers and Lewellen (2003) supported the findings by DuCharme et al. They found that Internet firms experienced considerable underpricing and that the media expanded their coverage of IPO firms in the month of the IPO, especially of

business-to-consumer firms. Other studies have shown that media coverage of Internet firms tended to be positive during the bubble and negative after the bubble burst. One favorable news item meant on average 7.0 basis points in return for the Internet firms (Bhattacharya et al., 2004). Low levels of positive coverage do not generally increase underpricing but it seems that when the coverage reaches a critical point, it does contribute to underpricing (Pollock & Rindova, 2003).

Looking at a six-month period prior to a firms' offer date, Cook, Kieschnick and Van Ness (2006) discovered that media coverage is related to offer price revisions. They maintain that exposure of a firm by the media attracts so-called sentiment investors which in turn increases the investment banker's compensation. Liu, Sherman and Zhang (2007) would concur with those findings as they concluded that sentiment investors, who were affected by media coverage, were more willing to buy a stock after reading or hearing about it in the media and to pay a higher price. In a more recent study, Liu, Sherman and Zhang (2009) found that one standard deviation increase in media coverage lead to 7.86% more underpricing of IPOs.

The relationship between media coverage, especially immediately prior to offer, and underpricing has also been found outside the United States, in countries where the stock market regulations are stricter; for example in Australia (Ho, Taher, Lee & Fargher, 2001; Jens, Brooks, Nicoletti & Russell, 2006) and Taiwan (Jang, 2007). In Australia, there is a mandatory seven-day media-black-out preceding a quotation of a firm on the ASX in order to prevent issuers from manipulating media coverage by sending out press releases (Ho et al., 2001) and in Taiwan there is a 7% daily price fluctuation limit, i.e. the share prices cannot exceed or dip below 7% of the previous day's closing price (Jang, 2007).

It appears that only one study contradicts the findings of the research projects that have been reviewed so far. Staikouras and Tsatsanis (2003) surveyed 687 companies that were listed on the London Stock Exchange from January 1st, 1997, to May 31st, 2002. On average, underpricing was 41.1% for these firms, with a median of 12.3%.

For the U.K. companies, it was found that there was a negative correlation between underpricing and media coverage during the week prior to quotation. Staikouras and Tsatsanis draw the conclusion that the media coverage provided investors with additional information about the companies.

To summarize, with the exception of one study on U.K. companies, studies have repeatedly shown a positive correlation between the underpricing of IPO firms and media exposure of these same companies prior to the stock market offering. The abnormal return on the first day has been attributed to media hype or a buzz that attracts sentiment investors that are willing to pay a high price for a share in companies that have received attention by the media.

Hypotheses

It is the purpose of the present study to examine whether there is a relationship between Icelandic IPOs and media coverage.

More specifically:

H₁: The more the media cover an issuing firm 14 days prior to the initial public offering, the higher the positive abnormal return of the IPO firm on its first day of trading.

H₂: The more the media cover an issuing firm during the first week of the IPO on the stock market, the higher the positive abnormal return of the IPO during that same week.

- H₃: The more the media cover an issuing firm during the first month of the IPO on the stock market, the higher the positive abnormal return of the IPO during that same month.

Methodology

Data

CreditInfo collects copies of all news articles published in the Icelandic newspapers, as well as transcripts of all newscasts on Icelandic radio and television. Thus, it would have been ideal for the present study to use the database of CreditInfo. Unfortunately, this turned out to be impossible as its database did not seem to include news on the earliest IPOs in the study. It was therefore decided upon to use the comprehensive and easily accessible database of the newspaper Morgunblaðið. This is, of course, a methodological limitation of the study that is presented in this paper.

Information on the opening and closing price of 25 firms that went public from 1998 to 2008 was acquired from the Nasdaq OMX Nordic stock market in Iceland. Those firms were all a part of the OMX15 at one time or another (see table 1 for a list of the firms included in the study).

Procedure

Media coverage was measured by counting the number of news items in Morgunblaðið that mentioned the IPO firm two weeks prior to the IPO, during the firm's first week on the stock market and during the first month. No attempt was made to classify the articles into good, bad or neutral. Previous studies have shown that coverage of IPO firms prior to quotation tends to be either positive or neutral (Cook et al., 2006)

The abnormal return of the companies was calculated from the opening price on day 1 and the closing prices on day 1, day 7 and day 30 (see table 1 for the opening and closing prices). The OMXIPI was used as a benchmark.

Once the abnormal return had been calculated and the number of newspaper articles counted, regression analysis was used to see if there was a statistically significant relationship between the media coverage and how the IPOs did during the first day, the first week and the first month.

Of course there are number of things that may affect the performance of IPO stocks. One of these factors is trading by insiders. Insider trading was controlled for in the regression by taking into account whether insiders had either bought or sold shares two weeks prior to the IPO. Information on insider trading was gained from the Nasdaq OMX Nordic and Landsbanki Íslands.

Table 1. Descriptive data for 25 IPO firms 1998-2008

Company	Name of company	Date	Opening price	Closing price on day 1	Closing price on day 7	Closing price on day 30
IG	Icelandic group hf	18.02.98	5.1250	5.1500	5.0500	4.6800
TNGI	Tangi hf	10.09.98	2.5300	2.4500	2.4200	2.2000
TM	Tryggingamiðstöðin hf	01.10.98	28.3000	28.0000	27.7500	27.5000
LAIS	Landsbanki Íslands hf	01.12.98	2.3500	2.4000	2.3600	2.3800
HTOR	Hraðfrystistöð Þórshafnar hf	12.01.99	2.9500	3.1500	3.1500	3.0000
OSSR	Össur hf	11.10.99	32.0000	31.5000	32.5000	30.8000
KOGN	Kögun hf	27.04.00	48.0000	47.0000	51.0000	45.0000
BAKK	Bakkavör hf	12.05.00	6.2500	5.9000	6.4000	5.9500
AUBA	Austurbakki hf	21.06.00	50.0000	49.0000	49.0000	48.0000
ATOR	Atoka hf	27.10.00	2.3800	2.3800	2.3400	2.2300
FMB	Fiskmarkaður Íslands hf	16.10.00	2.0000	2.0000	2.0000	1.9000
KAUP	Kaupþing hf	30.10.00	15.0000	15.0000	15.5000	15.5000
STRB	Straumur Burðarás hf	30.10.00	3.3600	3.3600	3.3600	3.2500
LTSJ	Líftækni sjóður Íslands hf	19.02.01	1.1800	1.2000	1.3000	1.4100
365	365 hf	13.06.01	8.0000	8.2000	6.7000	4.2000
SIMI	Síminn hf	08.10.01	6.1000	6.1000	5.7500	5.9000
TF	Tækifæri hf	27.01.03	1.0000	1.0000	1.0000	1.0000
FLAGA	Flaga Medcare hf	27.11.03	6.0000	7.0000	7.0000	6.2500
FIEY	Fiskeldi Eyjafjarðar hf	05.06.03	1.0000	0.7500	0.7500	0.7500
HFEIM	Hf Eimskipafélag Íslands	20.01.06	49.1000	45.4000	41.9000	41.0000
EXISTA	Exista hf	15.09.06	23.0000	22.6000	23.6000	22.6000
TEYMI	Teymi hf	21.11.06	4.5400	4.5300	4.3100	5.1400
ICEAIR	Icelandair hf	14.12.06	27.8000	27.6000	27.4000	28.6000
SPRON	Spron hf	23.10.07	18.9000	16.7000	15.4500	10.9700
SKIPTI	Skipti hf	18.03.08	6.5500	5.7500	6.0000	7.1000

Source: Nasdaq OMX Nordic in Iceland.

Results

Generally, IPOs have a tendency to outperform the market index on their first day (Bodie, Kane and Marcus, 2009). It has been suggested that the IPOs are deliberately underpriced in order to gain good impressions among investors.

The results of the present study contradict this general assumption. Thirteen of the 25 Icelandic companies included in this study closed lower than their opening price on the first day and they did worse than the market index (Figure 2). The performance of those IPOs wasn't much better after the first week (Figure 3) or even after the first month (Figure 4). It's safe to say that one does not make money by investing in Icelandic IPOs.

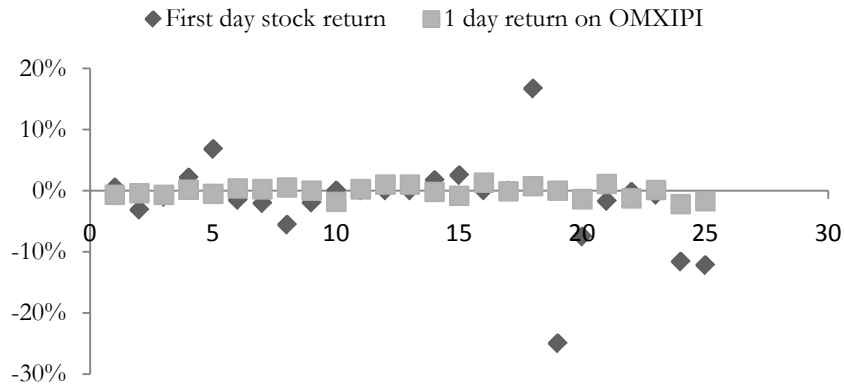


Figure 2. The first day stock return of IPOs

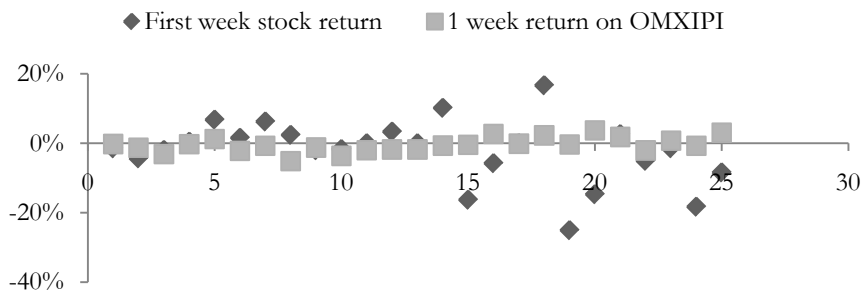


Figure 3. The first week stock return of IPOs

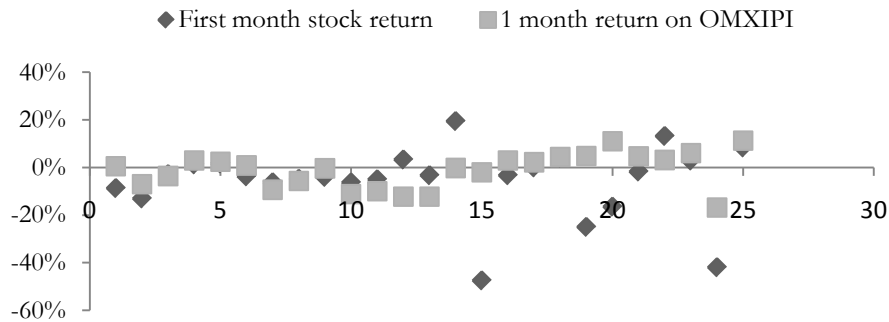


Figure 4. The first month stock return of IPOs

With one exception, studies that have been conducted in other countries have found that IPOs are often underpriced and that media coverage days or weeks prior to issue increases underpricing. Again, Iceland seems to be anomaly. The results from the regression indicate that although insider trading (insider buying) correlates significantly and positively with the abnormal return of IPOs, each news article that is published about a firm two weeks prior to the IPO means 1% decrease in abnormal return ($p < .05$).

In a nutshell, H_1 was supported but no relationships were found between the media coverage during the first week or the first month of the firm on the market and the abnormal return during that same period.

Discussion

The present study failed to replicate the findings of DuCharme et al. (2001a; 2001b) and others who have in the past found a positive relationship between underpricing of IPOs and media coverage. Contrary to expectations, there was a significant negative correlation between media coverage and the price of IPOs in Iceland.

Caveat: The sample size for this study was small and only included 25 firms. Also, one cannot exclude the possibility that the results might have been different if one had had access to more media sources. This study is only based on the coverage of one newspaper, Morgunblaðið.

It's difficult to draw any firm conclusions from these results. The findings may simply be due to methodological limitations or one could claim like Staikouras & Tsatsanis (2003) that the media serve to inform investors about the status of IPO firms and thus decrease the price of the stocks. Nevertheless, it appears that Icelandic IPOs are usually overpriced. Either way, this study reveals the need for further studies on this subject.

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