Hold the front page

Research examines whether news releases from corporations can game the investment system

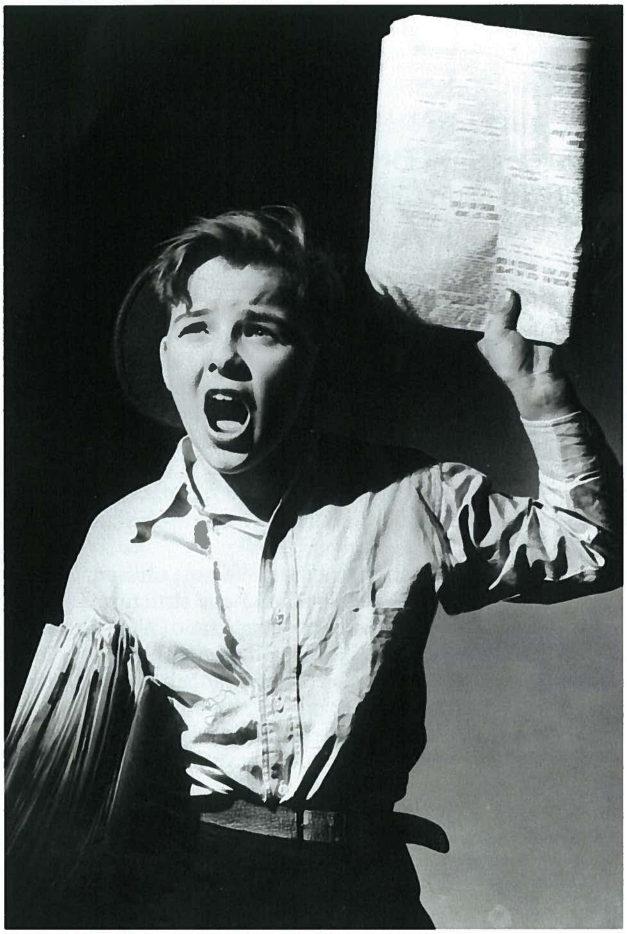
The way the flow of information is controlled is vital to the efficient running of financial markets and economies. Information may, for example, prompt stakeholders, including suppliers, employees and investors, to get involved or cut ties with a firm.

Availability of information also protects those who are not in the know from losing out. That's why business regulation aims to discourage selective disclosure, evening up stakeholders' access to information, banning some kinds of insider trading. However, there are still opportunities to game the system, as London Business School's Alex Edmans and his co-researchers discovered.

The authors focus on corporate news releases, an important source of news issued at the discretion of the CEO detailing certain corporate events, and which has the power to affect share prices. Attention grabbing news disclosures, for example, steer investors towards buying particular shares, producing temporary price increases. Equally, disclosing information may lead investors previously unaware of the information to buy shares pushing the price up.

The authors investigated whether CEOs might time news releases to increase the prospects of a better return when selling equity in their company. To ensure it wasn't the news triggering the sale of equity, the researchers looked at 'vesting months' when stock or options were scheduled to vest, as the scheduling of these periods was determined some time previously. Research shows that executives tend to sell equity shortly after it vests and so this creates short-term concerns for them about the stock price.

Using a sample of 166,000 news releases, the authors were able to separate discretionary news likely to be under a CEO's control, such as conferences, client and product announcements and special dividends, from non-discretionary news, such as AGMs and earnings announcements. They also distinguished between news released by the media or by the firm.



Well-timed news releases can affect stock price

The analysis revealed that firms release much more discretionary news in vesting months than in non-vesting months. In addition, firms significantly reduce disclosures in the months before and after the vesting month. And, going by the positive media reaction to news releases in vesting months, CEOs tend to release more favourable discretionary news in vesting months than they do in non-vesting months.

The release of attention-grabbing good news affects the share price, providing a temporary boost that benefits CEOs about to sell their equity – a significant 16-day abnormal return of 28 basis points (bps). Applied to the average annual CEO vesting equity of $5.18m produced by the research data, it creates a gain of $14,504.

It is, say the authors, "in line with the gains to illegal insider trading". The gains are even greater if CEOs disclose several news items. Better still, the authors note, "changing the timing of news releases is legal, and involves less effort than other actions to boost the stock price, such as cutting investment projects." Plus, increased trading volumes linked to the news release provide useful market liquidity for the CEOs' share trades.

Where CEOs gain, other stakeholders may lose, though. The market does not appear to factor in any strategic timing of news by CEOs. This suggests that, while CEOs may benefit from a boost in share price, numerous stakeholders making decisions prior to (or immediately post) the vesting months are doing so with less information than might otherwise have been available, and not benefiting from any price rise that might have arisen from delayed news releases.

The lesson for investors is that corporate news can be used strategically to affect share price. Investors should take this into account before buying or selling stock.

CEOs tend to release more favourable discretionary news in vesting months than they do in non-vesting months

Resources

Alex Edmans, Luis Goncalves-Pinto, Yanbo Wang and Moqi Xu, 'Strategic news releases in equity vesting months', http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2489152