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Executive Summary of “Business Press Coverage and the Market Pricing of Good and Bad News” (with Jeremiah Green and John Hand)

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Background:

The delivery of business news has transformed substantially with the development of new communication technology. Both the number of news providers and the methods of delivery have increased creating an information environment with unprecedented levels of immediate access to the business press. While traditional news sources have served as gatekeepers seeking to select, investigate and report on important stories using a limited page space, many modern news sources have sought to provide rapid, broader coverage of a larger set of news events. We seek to address two primary questions prompted by these changes in the production and delivery of news reporting as well as by the differing objectives and incentives across news providers.

Research Questions:

We first ask: are there empirically observable differences in attributes of news reporting amongst different news source types? We address this question by looking specifically at differences in coverage of good news and bad news events by traditional news sources and by modern news sources. Traditional news providers include the national press, local news channels and newswires while modern news providers, include Internet-based news outlets and news aggregators.

We identify both good and bad news reporting biases which vary depending on the news source. We find evidence of a bad news bias in that bad news business stories receive more
coverage than good news stories from each traditional news source. We find the opposite, however, for modern news providers which exhibit a good news bias. We also find variation in good and bad news bias by type of news story and firm size. For instance we observe that the gap between good and bad news coverage is smaller for stories that are based on firm fundamentals.

Results of tests related to the first question lead to our second research question: do differences in news coverage matter? More specifically we ask: do different news sources effectively select stories that are more important to investors through their coverage decisions? We address our second question by examining whether the amount of coverage from different news sources is associated with how investors price news. We focus on the pricing of good and bad news by testing for variation in the contemporaneous one-day stock return and the one-month-ahead return to good and bad news sorted by both the level and source of news coverage. We anticipate and identify differences which vary across news sources, and we use results from these market tests to infer what incentives and objectives primarily influence the business press. We also use these results to evaluate how the market interprets reporting from different news sources.

**Hypotheses:**

Tests relating to the second research question are framed in the context of three hypotheses: (i) the information intermediary hypothesis; (ii) the self-interested story selection hypothesis; and (iii) the firm visibility increasing hypothesis. These hypotheses are not mutually exclusive, but they do describe different incentives or objectives that may influence a news provider in their coverage decisions which we expect to have varying effects on market returns in response to that news coverage. Each hypothesis is discussed briefly below.
**Information Intermediary Hypothesis** – If press coverage is intended to inform investors then we expect that coverage decisions by journalists will be made consistent with that purpose providing some or all market participants with new information. If the press coverage is solely intended to serve the information intermediary role, we would expect greater press coverage to be associated with a stronger and more immediate response to good and bad news with no predictable returns following the initial market response.

**Self-Interested Story Selection Hypothesis** - Journalists often face incentives to increase readership, or to enhance individual or publication reputation. Such incentives may lead journalists to choose stories that are more likely to attract readers’ attention such as stories about large firms or bad news event stories which seem more salacious or memorable than good news stories. News coverage that is selected on the basis of a news provider’s self-interest may result in stronger immediate reactions to news events. The redundant dissemination of non-informative news may spur investors to place excessive attention on particular news events which seem to be more important than they actually are due to the prominent coverage the event receives. Evidence of this type of potential overreaction to news stories would be reflected in the subsequent reversals of initial overreactions. If press coverage decisions are driven by the self-interest of journalists we expect greater press coverage to be associated with stronger reactions to news, in particular to bad news or news for large firms, with a subsequent reversal.

**Firm Visibility Increaser Hypothesis** - It is also possible that press coverage will attract readers’ attention to firms not previously considered by investors for inclusion in their portfolios. In this manner attention to the business press can make the firm being reported on more visible to potential investors. In the presence of short sale constraints, the increased visibility then leads to
increased demand for stocks putting upward price pressure on the stock\(^1\). This demand shift leads to a decreased reaction to bad news and an increased reaction to good news. We also expect to observe higher prices irrespective of the news event. The difference between the firm visibility increaser hypothesis and the self-interested story selection hypothesis then rests on the different prediction for the reaction to bad news; rather than a stronger reaction to bad news, visibility predicts a reduced reaction to bad news. The firm visibility increaser hypothesis also differs in that there is no predicted reversal in returns as there is for the self-interested story selection hypothesis. The predictions for the reactions to good news are similar. In sum, this hypothesis predicts that greater press coverage will be associated with reduced reactions to bad news, increased reactions to good news, and high prices overall with no subsequent reversals.

Results:

Generally, we find that all sources of business press seem to serve as gatekeepers to some extent publishing stories investors react to more strongly with increased coverage (consistent with the information intermediary hypothesis) particularly for good news. We find limited evidence of some news sources prioritizing story selections that garner readership with attention grabbing news events over story selections based on informational contribution (which would support the self-interested story selection hypothesis). Our evidence also indicates that press coverage enhances firm visibility, leading to higher demand for the firm’s shares (supporting the firm visibility increaser hypothesis). We conclude that while coverage of stories in the business

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\(^1\) It is plausible that increasing a firm’s visibility with a good news story will result in increased demand for the firm’s stock as investors previously unconcerned with the firm now include the firm in their investment decision process. It is also possible that bad news stories will result in increased demand for the firm by investors who suspect that the firm may be a value following price declines associated with the bad news. It is less likely that new investors unfamiliar with the firm will respond to its increased visibility by pursuing a trading strategy in which they take a short position in the firm’s shares.
press does provide value-relevant information to investors, the relationship between coverage and a firm’s visibility is predominant.

Our findings provide some context to research that studies specific news events or specific news sources. Our findings also suggest that an important avenue for future research is to further understand the visibility role of the business press as well as to understand under what conditions the business press acts in its other capacities in grabbing investor attention or in providing new information to capital markets.