Corporate communication and reputation: an in-depth analysis into impact, practices, and reputational aspects tied to M&A announcements

Conference or Workshop Item

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An in-depth analysis into impact, practices, and reputational aspects tied to M&A announcements

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SUMMARY

The objective of the research is to observe share price reactions to information announcements during M&A processes. We shall focus upon the London Stock Market as this is the second most active M&A market in the world and a market in which one of the researchers has a great deal of direct experience. In doing so, we propose to uncover i) what types of information make a difference to share prices, ii) the importance of the timing of this information release, and iii) whether there are firm specific and group reputational effects which lend information more or less credibility. This research will provide corporate practitioners with empirical evidence regarding the impact of different corporate communication practices in terms of their content and timing. The research will also be able to answer the extent to which aspects of prior reputation gives weight and credibility to communications, and whether this is a generic quality or more specific to the information being provided, for instance whether being a well run company is sufficient to add credibility or whether specific experience in the issue at hand makes the difference. Finally, with regards to outcomes directed at High Status Reputation Intermediaries, the research will provide insights into whether or not, and to what extent, the involvement of professional advisors makes an impact in lending their reputations to enhance the effectiveness of company messages being communicated to the markets.

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Introduction

Corporate communications are central to corporate reputation. Stock prices are driven more by perceptions than fundamental values (Fombrun, 1990, 1996) and corporate communication practices are key in shaping investors' perceptions. While intangible assets of firms are studied widely in the strategy field, researchers have recently shifted their attention on a more narrow set of intangible assets called "social approval assets" (Pfarrer, Pollock, & Rindova, 2010) which include reputation(s) and celebrity statuses of organizations. Social approval assets derive their value from favorable collective perceptions (Pfarrer et al., 2010). This research proposes that corporate communications help shape collective perceptions and therefore contribute to building and/or sustaining social approval assets within organizations. The underlying assumptions of this research are the following: i) corporate communications can and do influence market prices; ii) different corporate communication practices are associated with different levels of impact on organizational performance; and iii) firm specific and group[1] specific reputation have an observable effect on communications outcomes[2].

Existing research on corporate communications illustrates that corporate communications can be influential not only in shaping and directing stakeholders' responses (Yakis-Douglas and Whittington, 2010), but also in accumulating high levels of public recognition of the quality of firms' capabilities and outputs (King & Whetten, 2008; Rindova et al., 2005). However, while much of the existing research focuses on the general effects of corporate communication on firm performance, it has given little consideration into *what elements* of corporate communications make a difference to markets.

Rather like the advertising maxim that "50% makes a difference, but we don't know which 50%", corporate communications seem to be in a similar situation with firms not being clear on what really matters. Is it the 'content' which causes markets to react? Or is it some quality of the message itself, such as its believability or trustworthiness, which may reflect a firm's existing reputation? Despite the widespread recognition that certain announcements have the power to move markets (such as issuing a profits warning, changing the CEO), this research draws

[1] Group here is taken to mean the cluster of professional advisors engaged in specific deal advice such as lead investment banks and law firms.

[2] A recent article (Pfarrer et al., 2010, Academy of Management Journal) presents empirical evidence illustrating that "high reputation" firms experience greater market rewards for positive earnings surprises and smaller market penalties for negative surprises than other firms. While Pfarrer et al.'s findings provide a strong backdrop for our research, we propose to carry out a more sophisticated and in-depth analysis regarding the different types, content, and timing of corporate communications among organizations that are characterised as "high reputation" and those are not.

attention to the importance of investigating *different types of corporate communications* in influencing markets. *We will therefore examine the extent to which different types of communication content may affect a focal firm's equity market price and assess the extent to which the focal firm's existing reputation may also play a role in how information impacts share prices.*

One context where specific communication is well known to be of great significance in moving the equity market is mergers and acquisitions. The announcement of a transaction regularly causes stock prices to move significantly, often around 20%-25% for a target company, and this observation is central to a considerable body of finance research which uses the announcement date of a transaction as the basis for performance analysis. Although there is significant attention to identifying appropriate event windows around announcement dates, there is very little discussion indeed about other informational moments in the M&A process. This is partly a reflection of the static cross sectional approach to performance evaluation in the Mergers and Acquisitions literature which privileges one moment in time over others and does not recognize that markets are continuously adjusting to real time changes in available information.

Therefore, the purpose of this research is to uncover **i) what types of information make a difference to share prices, ii) the importance of the timing of this information release, and iii) whether there are firm specific and group reputational effects which lend information more or less credibility.**

Data

The objective of the research is to observe share price reactions to information announcements during M&A processes. We shall focus upon the London Stock Market as this is the second most active M&A market in the world and a market in which one of the researchers has a great deal of direct experience. We have gained access to Thomson Reuters NewsScope which is a real time deliverer of up-to-the-moment news to markets. Thomson's assertion is that Thomson Reuters NewsScope delivers immediate news which directly affects markets. This is on the basis of news being delivered faster than, or as fast as other sources. This vast data archive details every piece of information released to the financial markets over time and is specific in terms of source, content and timing. For our purposes we are able to track the progressive release of news for any individual merger and acquisition from original rumor through the entire process to post acquisition actions.

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Method

The methodology of this research consists of two parts: cross sectional and longitudinal.

i) The *cross sectional* analysis will be used to assess the effect of M&A announcement upon share price using an event study methodology. To explore abnormal returns, the analysis will compare a sample of companies making recent M&A announcements across a broad cross section of the market. As share prices react in varying ways to M&A announcements, the variations will be compared with content of the announcement and variables relating to company reputation (including prior M&A experience, use of advisors, financial health, size Fombrun 1996; Ferguson et al. 2000)).

ii) The *longitudinal* analysis will focus upon a specific sub-set of M&A. These are chosen in order to assess the effects of (a) different M&A strategy types, (b) deal complexity, (c) overseas acquirers, (d) firm specific characteristics. Information release will be matched against real time share price movements, from a source such as DataStream, using time series analysis. This will enable conclusions to be drawn about how different information types, their 'quality' and timing link with market movements. Through this method conclusions may be drawn about the role information plays in affecting stock markets in the M&A process. It will also enable company communication releases to be contextualised in terms of their ability to make a difference to share prices in comparison to other non-company sourced information being released.

Outcomes

Contributions to M&A and Strategy literature

The M&A literature has long observed significant variation in performance based upon share price movements around announcement dates. The first part of the analysis outlined above would answer questions about the importance of information content at the time of announcement and the role of the reputational characteristics of the firm, including the use of advisors, which may affect share price movement.

Whilst the M&A literature observes that communications do make a difference within the firm (Schweiger and deNisi 1991, Ellis et al., 2009), and very recent attention has begun to be directed at discourses of M&A in the media (Cummings and Riad, 2007; Vaara, 2007), little empirical work has been directed at the external role of communications throughout the process and its effect upon share price movement. The longitudinal analysis will be able to show which types of information make a difference and at what points during the process. It will show the differential impact of financial, strategic, marketing, operational, and HR related information and the role of prior firm and group reputation in affecting the effectiveness of communication. This may help to inform the role of intangible resources, both firm specific and collective, in assisting corporate strategies (Deephouse 2000).

Contributions to Corporate Reputation literature

In terms contributions to the literature on corporate reputation, this research follows the recent turn in reputation towards treating reputation as an asset that is influenced and protected not only through enacted strategies of the firm, but also through the deliberate management of communications, rhetoric, and discourse (Rindova et al., SO, 2007).

Also, by contributing to the understanding of how favourable collective perceptions can be built and sustained through different forms of corporate communication, this research adds to the reputation literature by following the growing interest in the subclass of intangible assets referred to as "social approval assets" (Pfarrer, Pollock, and Rindova, AMJ, 2010).

Furthermore, by analyzing the impact and content of different types of corporate communications longitudinally and in-depth, this research contributes to the Center's objective of "developing an understanding on how firms invest, store, and expend reputational capital". It is therefore in line with the Center's research agenda regarding "returns to reputation".

Finally, the current research also fits two of the "five themes of reputation" within the CCR agenda. The in-depth analysis into the content of corporate communications uncovers good versus bad practices that are likely to be of interest for, and reflective of the practices of High Status Reputation Intermediaries. The longitudinal research focusing on the impact of M&A announcements supports the idea that the power of reputation lies in its signaling effect.

Practice-related outcomes

This research will provide corporate practitioners with empirical evidence regarding the impact of different corporate communication practices in terms of their content and timing. In doing so, our research is aimed at shedding light into understanding the impact of different types of information being communicated to the markets – for instance whether financial information carries more weight than operations based information. There will also be insights in terms of the timing of information release and whether there is an entropic effect overall.

The research will also be able to answer the extent to which aspects of prior reputation gives weight and credibility to communications, and whether this is a generic quality or more specific to the information being provided, for instance whether being a well run company is sufficient to add credibility or whether specific experience in the issue at hand makes the difference.

Finally, with regards to outcomes directed at High Status Reputation Intermediaries, the research will provide insights into whether or not, and to what extent, the involvement of professional advisors makes an impact in lending their reputations to enhance the effectiveness of company messages being communicated to the markets.

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