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## **Advertising for Listing: Empirical Evidences from the Italian IPOs**

# Advertising for Listing: Empirical Evidences from the Italian IPOs

## 1 - Introduction<sup>1</sup>

Stock markets are increasingly open to non-professional investors (NPIs)<sup>2</sup>, like families and individuals. The variety of financial product, the deregulation of stock markets, the evolution of IC technologies have given the private investors a wider and, in some cases, more direct access to stock exchanges and financial "products".

The above mentioned changes have strong implications for listed companies, whose shares are increasingly owned by "consumers". Their "financial behaviors" are actually quite different from those applied by professional investors (PIs)<sup>3</sup>, such as banks or financial institutions. For example, figures and forecasts about the firm's balance sheet are the source of the decision for a professional investor. On the contrary, an individual can be influenced, choosing a stock to buy, by criteria that are less than purely rational.<sup>4</sup> He is usually less able in interpreting a balance sheet and rumors or ads about the firm can give a feeling of confidence or uncertainty about the stock. Thus, when a public company wants to communicate to the market, it has to bear in mind that "the market" is also made by NPIs, which can be targeted through media and messages others than those traditionally exploited for PIs. This is particularly true in some specific situations, which are information-intensive in their nature. One of these situations is the Initial Public Offering (IPO), when a company sells its shares to the market for the first time, starting its listing in a stock exchange. An IPO is a very critic momentum for the financial communication of the company, because the product which is sold (the share) is new to the market, and require a quite intensive communication effort: a communication which has to be direct to different targets, both PIs and NPIs. An IPO is thus not only a mere financial problem, but involves also marketing issues such as selecting the "right" media and the "right" messages to use to contact (and convince) the "right" targets of potential shareholders. As far as potential NPIs are concerned, an IPO communication may require the use of mass advertising.

The aim of our paper is to deepen the research of the interaction between IPO and marketing by analyzing the communication behavior of Italian IPOs with particular reference to NPIs.

The reason is twofold.

On the one hand, the critical role played by communication activities supporting an IPO is quite evident: market's perceptions are fundamental for the success of the entire operation, because an "IPO performance primarily depends on the perceptions of potential investors"<sup>5</sup>. Obviously, perceptions can be influenced through different tools. For example, an IPO can signal its value to the market through the shares price, through the underpricing, through the reputation of the banks involved in the operations, through the composition of the company's board. While those signals

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<sup>1</sup> We wish to thank Tito Favino (SCJ, Milan) for having kindly provided the data on the communication investment of the Italian IPOs.

<sup>2</sup> From this point on we use the acronym NPIs to denote "non-professional investors".

<sup>3</sup> From this point on we use the acronym PIs to denote "professional investors".

<sup>4</sup> Kahneman, 1994; Thaler, 1993.

<sup>5</sup> Argawal; 2003, 432

are an implicit way to evaluate the firm<sup>6</sup>, marketing communication is a more explicit way to signal and to communicate to the market: a board composition is not easily modifiable to impress the market, the price of the stock is constrained by the financial wealth of the company, while an advertising campaign is more easily manageable by the firm. The uncertainty that surrounds the IPO – that can be called “liability of newness”<sup>7</sup> - can be consequently smoothed by an effective marketing communication. The success of the public offer is thus seriously affected by communication issues. No surprise, therefore, that a media planning for an IPO is more and more frequent, like in the case of a new product launch in commercial industries.

On the other hand, NPIs represent increasingly a significant target of the IPOs operations. According to the Wall Street Journal “Traditionally, individuals [NPIs] get between 10% and 20% of IPO shares at the offer price”<sup>8</sup>. The Italian IPOs have even a higher figure: on average, 33% of the IPO’s offer is allocated to private investors<sup>9</sup>.

Marketing is thus a necessary tool for an IPO. But the reverse statement is also true: the IPO is such an event that it is a marketing opportunity to give a bust to the company’s brand. Some stock market entries are explained by the desire to create a “buzz” around the IPO and, therefore, around the company name. That is clear in cases like that of Netscape<sup>10</sup> or Amazon<sup>11</sup> when the IPO was – almost primarily - a powerful marketing channel in itself to get the firm known. Joy Covey, chief financial officer of Amazon at the time of its IPO revealed<sup>12</sup>:

“The company did not need to go public at the time to raise capital...[w]e decided that the brand exposure would be invaluable to the company...”

Dealing with marketing communication does not imply to refer exclusively to advertising. The tools of integrated communication comprehend also road shows, public relations and any other way to communicate to the environment.

The IPO usually follows, as an apex, the ‘road shows’ where the management of the firm meets potential investors and introduce them to their competencies<sup>13</sup>. The IPO in itself is an event that communicates the existence of the firm and the stability that had allowed for the stock market placement. This is coherent with the new competence-based communication approach developed by Golfetto<sup>14</sup>. Thus, the brand and the competence of the firm have the IPO as an opportunity to emerge.

## **2 - Theoretical background and hypotheses**

The literature acknowledges the relationship between financial market and product market<sup>15</sup>, between financial structure and performance. Narrowing that tie, recent literature shows that it exists a relation between IPO and marketing.

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<sup>6</sup> Spence, 1973

<sup>7</sup> Argawal, *ibidem*.

<sup>8</sup> Wall Street Journal February 28, 2000, p. C21

<sup>9</sup> This mean is drawn from our population of study (see below for details).

<sup>10</sup> Demers, Lewellen; 2003, p. 414

<sup>11</sup> Song et al.; 2001, p. 49

<sup>12</sup> Amazon.com – Going Public (Harvard Business School Case).

<sup>13</sup> Song et al.; *ibidem*

<sup>14</sup> Golfetto, 2003.

<sup>15</sup> Stoughton et al.; 2001

That link between IPO and marketing can be split into two directions of causality: from the IPO to its marketing effects and viceversa.

Demers and Lewellen<sup>16</sup> analyze the relationship between IPO's underpricing (i.e. the first day price gain) and marketing. They show that an underpricing of the IPO's shares bears marketing benefits, measured as traffic increase for the firms' web-sites (the companies studied by the two authors are Internet-based). In particular, they state that "initial returns are significantly positively associated with the number of media mentions in leading newspapers in the month of IPO" (ibidem, 431), showing a tie between IPO and communication. In their scheme, the underpricing raises the attention of media and investors, creating a good publicity for the company. Through that increased attention the performance of the firm improves.

Song et al.<sup>17</sup> clearly states that "an IPO does have a significant impact on marketing" raising attention around the event of the entering of the firm into the market. Also Aggarwal et al.<sup>18</sup> and Demers and Lewellen<sup>19</sup> show that a big underpricing raises media attention. The authors suggest to include marketing managers in the Initial Public Offer planning. The financial information and the marketing ones should be tied together in order to create "positive financial and image side effects"<sup>20</sup>. In particular, the marketing approach suggests to enlarge the target of communication beyond the strict financial institutions and to conduct advertising campaigns.

This broad and rich communication complies also with the stock exchanges rules about fair disclosures of company's information.

Nelson<sup>21</sup> and Milgrom and Roberts<sup>22</sup> analyzed the phenomenon according to which a firm employs any visible expenditure to communicate to the consumer the quality of its new good. The IPO's underpricing is a case of that communication<sup>23</sup>. This is coherent with the signal theory<sup>24</sup>, above mentioned.

Du Charme et al.<sup>25</sup> support a "branding hypothesis"<sup>26</sup> they expect that the underpricing of an IPO of a B2C firm should be greater than B2B firms. Their result are coherent with the hypothesis but the sample is limited to Internet firms.

According to the existing literature on IPOs and the basic principles of communication theory,<sup>27</sup> one can expect a positive correlation between the fraction of the offer allocated to NPIs (as opposed to that addressed to PIs) and investment in mass advertising: mass advertising (TV, press, radio, ecc.) is actually more suited for communicating to general public. This correlation would show that marketing is relevant for the IPO above all when individual are more heavily involved in the allocation.

Therefore we can assume that:

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<sup>16</sup> Demers, Lewellen, 2003

<sup>17</sup> Song et al.; 2001, p. 52

<sup>18</sup> Argawal, *ibidem*.

<sup>19</sup> Demers, Lewellen, *ibidem*

<sup>20</sup> Song et al.; *ibidem*

<sup>21</sup> Nelson, 1974

<sup>22</sup> Milgrom, Roberts, 1986

<sup>23</sup> Demers, Lewellen; 2003, p. 422

<sup>24</sup> Spence, 1973

<sup>25</sup> Du Charme et. al.; 2001

<sup>26</sup> Demers, Lewellen; 2003, p. 415

<sup>27</sup> Fabris, 1997; Golfetto, 1993.

*P1a: The larger the quantity of shares offered to NPIs, the higher the communication investment made by the IPO.*

*P1b: The larger the quantity of shares offered to PIs, the smaller the communication investment made by the IPO.*

Another relationship between an IPO's features and its communication strategy which is drawn by existing literature is that between underpricing and advertising investment. As high initial returns at the time of IPO raise media attention and create publicity for the issuing firm, underpricing can be thought of as a surrogate of direct advertising investments. In other words, the issuing firm can, on one hand, "leave money on the table" intentionally under the form of an high underpricing while, on the other hand, saving advertising expenditures. Thus we can expect that:

*P2: The larger the underpricing of an IPO, the smaller is its related advertising expenditure.*

The relationship between communication investment and underpricing may also have an opposite direction. A large communication effort, through high advertising investments, means that the market gets more information about the firm. Therefore the price of the first day of negotiation should be close to the offered price, since the market can better detect the real value of the firm, without over-evaluating it. Accordingly, we propose the following

*P3: The larger the advertising expenditure of an IPO, the smaller its underpricing.*

### **3 - Methods and Results**

#### **3.1 - The Data**

In order to test the previous hypotheses, we gather data about Italian IPOs which took place between the years 1999 and 2001, for a total of 79 companies. For each company we collect:

1. General information about the issuing company: such as its activity, turnover, number of employees, and so on;
2. IPOs features: such as the % of share reserved to NPIs and to PIs, the price, the underpricing, and so on;
3. Advertising expenditures of the IPOs on mass media like TV, radio, press, cinemas.

The variables collected for every IPO are in total 36.

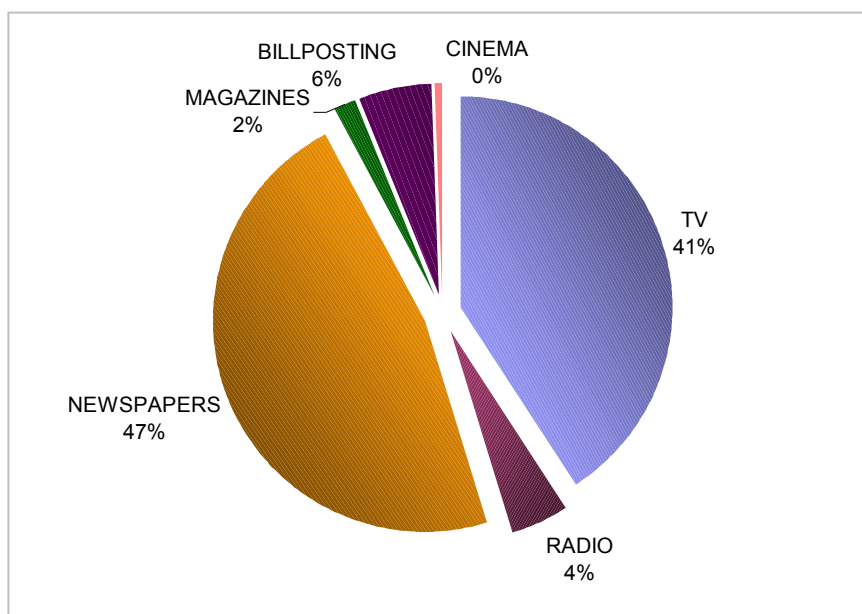
As regards points 1 and 2 we use different sources: official documents issued by IPOs companies, by Borsaitalia (the Milan Stock Exchange) and press articles. As regards advertising expenditures we used the Nielsen Database, which collect data about mass advertising for the Italian market. For each IPO we consider the advertising made in the three-months period before the event. Table 1 contains descriptive statistics of the main variables we analyzed.

Our data confirm the important role played by communication in an IPO: the average advertising spending exceed 615,000 euros, which is a quite large investment if we consider that it's distributed in a very small time (usually the months of the IPO and the two previous months). With reference to the different media implied, fig. 1 shows that the largest part of the communication expenditure is put in newspapers (48%) and TV ads (41%). Advertising spending in newspapers

and TV are correlated, showing that an IPO usually conducts a campaign both on the press and on TV. Cinema is used by only two IPOs.

	Minimum	Maximum	Mean	Std. Deviation
No. Offered Shares (million)	0.30	3848.80	85.16	443.61
No. Demanded Shares (million)	0.87	12,977.94	379.05	1625.81
Oversubscription Ratio	1.00	83.82	8.06	13.64
Shares Offered to Individuals (%)	9.67	100.00	32.98	16.66
Shares Offered to Institutions (%)	0.00	85.31	63.10	16.83
Offer Price (Euro)	1.13	176.00	24.32	32.08
Underpricing (%)	-37.35	532.6	18.01	66.99
IPO Proceeds (Euro million)	8.93	16,549.85	403.64	1,882.44
No. Employees	7	84,938	2,634.06	10,253.49
Corporate Revenues (Euro million)	1.96	116,988.30	3,536.68	17,512.79
Communication Investment (Euro/000)	9.00	11,983.00	615.15	1,760.64

**Table 1: Descriptive Statistics of Italian IPOs**



**Fig. 1 Italian IPOs' advertising expenditures, by media**

The use of communication media differ also according to the segment of the stock market where the issuing company is going to be listed. In our sample we have three different segments: Borsa, Numtel and Star. Figure 2 splits advertising expenditures by media in the different segments revealing significant differences both in the amount of communication budget and the media used.

An interesting result is that the investment in TV advertising does not correlate with the company's revenues and it is has the largest variance among the communication means. This would

indicate that TV ads are a choice made by the firm most likely due to the industry of the IPO (whether B2B or B2C) and to the marketing strategy adopted by the IPO.

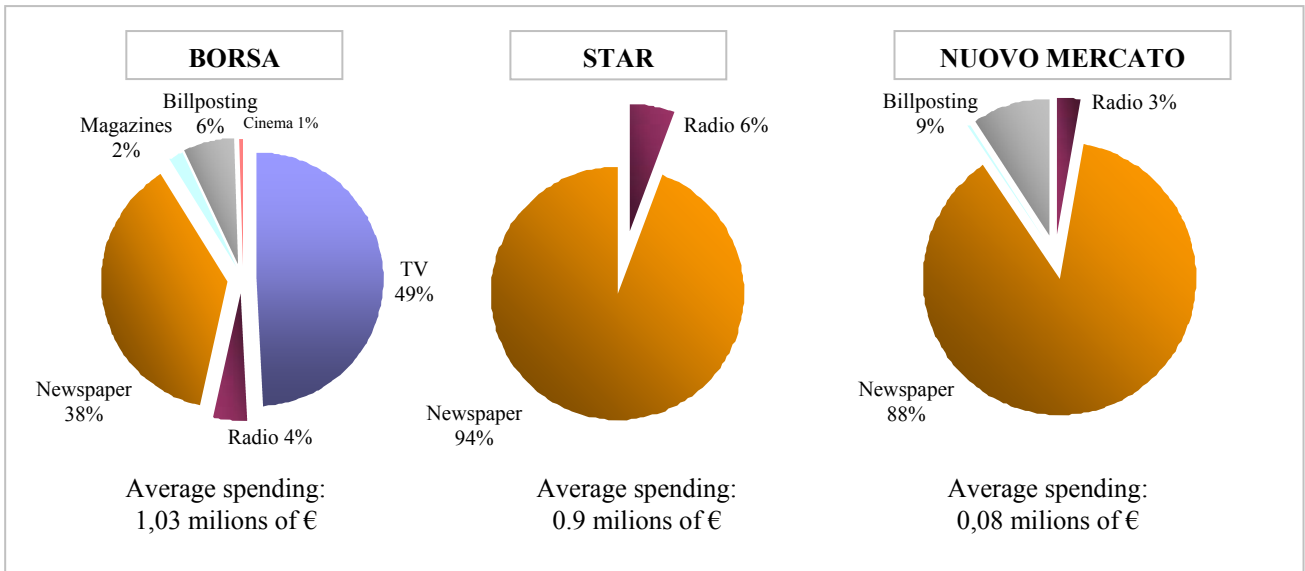


Fig. 2: Italian IPOs' advertising expenditures, by media and stocks markets

### 3.2 - Test of Hypotheses

In order to test P1a and P1b, we selected the following measures, which are expected to have a stronger influence on the IPOs communication strategy:

- N. of shares reserved to NPIs on the floating (% NPIs on FL);
- N. of shares reserved to PIs on the floating (% PIs on FL).

The following table shows the correlation analysis.

		Communication Investment.
% NPIs on FL	<i>Pearson Correlation</i>	,146
	<i>Sig. (1-tailed)</i>	,099
% PIs on FL	<i>Pearson Correlation</i>	-,222*
	<i>Sig. (1-tailed)</i>	,025
<i>N</i>		79

\* Correlation is significant at the 0.05 level (1-tailed).

Table 2: Correlation between communication investment and NPIs, PIs shares on floating

The results clearly support only P1b, while the correlation between %NPIs on FL and advertising expenditures, although positive, is not statistically significant (p: 0,099). The not fully significant correlation for NPIs can be explained by an even stronger marketing proposition: if the communication investment were detached from the fraction of the offer allocated to individuals, the communication effort may have the form of branding. Using the opportunity of the Initial Public Offer, the company enhance its brand thorough communication, regardless the numbers of NPIs involved. This hypothesis is reinforced by the fact that brand is particularly relevant when the company is under the review of different types of stakeholders, both public and private. In other words, we can hypothesize that advertising surrounding IPO doesn't point toward the mere "selling" of shares to specific targets, but can have broader marketing goals, such as strengthening company image and reputation. This fact can weaken the relationship between advertising expenditures and NPIs shares.

Anecdotal evidences support those propositions. For instance, Fiera Milano - the main Italian trade show organizer – based its communication investment on its image and not on the strict informational content of its Initial Public Offer. The management of Fiera Milano exploited the attention to its offer in order to establish a clear position in the mind of customers and stakeholders.

These statements can be tested by a content analysis of the communication campaigns of the IPOs, for which we expect the messages conveyed not to be informational (i.e. focused on the offer and its features such as price, modalities of purchase, warranties, underwriters, merchant banks involved) but to be more related to the brand of the company.

As regards the hypothesized relations between underpricing and advertising expenditure, testing results for P2 and P3 are reported in table 3.

		<b>Communication Investment</b>
<b>Underpricing</b>	<i>Pearson Correlation</i>	-,079
	<i>Sig. (2-tailed)</i>	,486
	<i>N</i>	79

**Table 3: correlation between "Underpricing" and "Communication investment"**

Also the one-tailed correlation is not statistically significant. Therefore, underpricing and communication investment are not correlated.

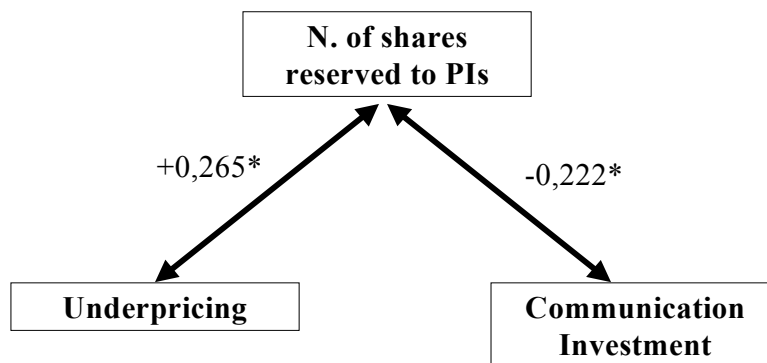
Some attempted conclusions that one can draw from this lack of correlation are:

- As to P2, undepricing in the Italian market seems to fail in creating a publicity that would avoid the use of marketing communication. This can be due to a less developed financial and press system that does not adequately signal interesting stocks.

This conclusion would show that the results by Demers and Lewellen<sup>28</sup> are idiosyncratically linked to the market studied. In some markets rumors and publicity would spread better than in other, thanks also to a higher number of financial newspapers that create a bandwagon effect.

- As to P3, marketing communication appears to fail in giving enough information and persuasion to affect the price of the stock. Economic figures of the shares and the issuer can have the most part in the underpricing phenomenon.

Still, the lack of correlation between the two variables can have a further explanation. Computing other possible correlation, a striking one involves underpricing, communication investment and the number of shares reserved to PIs. The correlations are illustrated in the figure 3.



\* Significant at the 0,05 level

**Fig. 3: Correlations Between underpricing, communication investment and the number of shares reserved to PIs.**

The PIs shares are negatively correlated with communication investments and positively correlated with underpricing. This arrangement of signs correlation could explain the lack of direct tie between underpricing and communication: a high amount of PIs shares, on the one hand, pushes the IPO towards underpricing and, on the other, reduce the need for advertising.

#### **4 - Conclusions**

The results obtained would like to contribute to the debate about the relationship between marketing and finance. Some evidence has been collected about the hypotheses formulated. They are not fully conclusive, but this is coherent with the openness of the debate and the complexity of the topic studied.

The link between marketing and financial aspects of IPO emerges from the data, even though not in a clear and unequivocal way. This is likely due to the complexity of the event studied and to

<sup>28</sup> Demers, Lewellen, 2003

the peculiarity of Italian stock exchange. Compared to Wall Street figures, the Italian market is younger and smaller. Moreover, the opening of the stock market to NPIs is more recent and still under development.

Future directions of the study can be a content analysis of the advertising by IPOs. Observing the actual meaning of the message conveyed by an IPO would make it possible to check whether a marketing approach is currently at work in the IPO's considerations.

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