

The Reaction Of The Italian Stock Market To Changes Of Recommendations

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Abstract

The objective of this paper is to examine the market reaction to the issuance of recommendation by financial analysts. We add to the previous international literature in several respects mostly due to the Italian peculiarity and for the unique dataset that we have created. Italy is an important case since analysts have to compulsorily send their reports to the Stock Exchange Commission and the Stock Exchange the same day they give it to their clients. Reports should be available on the Stock Exchange website within a period of 60 days. As far as we know there is no other country in the World in which this delayed compulsory disclosure is provided. We have constructed a database that includes 22,194 reports issued on companies listed in the Italian Stock Exchange from September 1999 to July 2005. For the purposes of our analysis we calculate abnormal returns and abnormal volumes associated with the dissemination of the reports, performing two distinct short-term event studies: the first associated with the “report date”, i.e. when the analyst gives the report to private clients; the second with regard to the “public access date”, i.e. when the report is freely and publicly available on the Stock Exchange website. First of all, we find a violation of law since some intermediaries send their reports after the term allowed by regulation, more precisely one third of the total number of reports issued from January 2004 to July 2005 seem to be in violation of law. At the report date we find average abnormal returns of 0.67% for upgrades, and of -0.74% for downgrades, coherent with the hypothesis that recommendations indeed convey new information to the market that efficiently react to these news. However, we find abnormal returns even some days before the report date. This can be the effect of other news affecting prices, e.g. earnings announcement, or the violation of Italian regulation. In a three days event window centered around the report date, we find that downgrades have an impact equal to -1.64%, in terms of CAR, while upgrades record a CAR equal to 1.38%, coherent in sign with previous studies in the literature, but not in magnitude, usually much more greater for downgrades. Our explanation is that in the period considered the percentage of upgrades and downgrades was very similar; therefore the market reacts almost in the same way. The event study related to the public access date show very different results. We do not find statistically significant abnormal returns, suggesting that the market efficiently does not react to the mere publication of the report on the website. It remains to be investigated if abnormal returns before the report date are due to the effect of price-sensitive news different from the recommendation change or if they mean violation of the Italian regulation.

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