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Information transfer and press coverage: The case of the Gawler Craton gold boom ☆

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Abstract

This study examines intra-industry information transfer after Helix Resources announced a successful drill result in the Gawler Craton region of South Australia that sparked significant investor interest in mining companies with tenement holdings in the area. This study shows that the price response of competing explorers was determined by press coverage immediately following the discovery of gold, but stocks that received the most press attention in the immediate post-announcement period suffered the greatest long-term underperformance. The research is the first in capital market literature to make use of geographical information systems software technology.
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1. Introduction

This paper examines the case of a famous gold discovery in South Australia made by Helix Resources. The discovery saw Helix's share price rise from 45 cents on the close of trading 1 day prior to the initial announcement on November 18, 1996 to US$3.70 at the close of trading on November 27, 1996, a 722% increase in just eight trading days. The issue we address is whether the wealth effects attributable to competing explorers with tenement interests in the area arose from information transfer, and/or news coverage.

☆ This paper does not express the views of Deutsche Bank AG or any of its associated parties.

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We find that initially, press coverage drove returns but stocks that received most press attention suffered the greatest long-term underperformance 1-year post-discovery. This result might be interpreted in two ways. First, the results might imply market overreaction stemming from complex information coupled with limited disclosure, an exotic location, and the existence of substantial news coverage. Alternatively, the results can be interpreted in a rational real options context. On balance, our evidence is more consistent with the latter interpretation.

Our findings can be compared with those of Niederhoffer (1971), who finds investor overreaction to newspaper headlines, as well as to those of Lang and Lundholm (2000), who find that increased positive disclosure prior to a seasoned equity offering (SEO) results in post-offering underperformance. The study also provides a fascinating contrast with DeAngelo and DeAngelo (1998) who find case evidence that press coverage influenced resource allocation in an important political debate involving the primary industry in the United States.

The remainder of this paper is structured as follows. In Section 2, we review the information transfer literature, and Section 3 examines literature concerned with the impact of news coverage on the capital market. Sections 4 and 5 contain a review of our testable propositions and research methodology. Sections 6 and 7 contain the results and conclusions of the study.

2. Theoretical background

According to Brown (1994), "information transfer refers to the process by which information conveyed to the market about one firm, the announcing firm conveys value relevant information about other non-announcing firms, usually confined to related firms or firms within the same industry." Dietrich (1989) suggests that information transfer studies assume that firm-specific information disclosures have industry-wide implications.

Prior empirical work on information transfer has evolved in two main areas. For example, Firth (1976), Clinch and Sinclair (1987), and Baginski (1987) have examined the existence, duration and magnitude of financial information transfer effects. Studies of nonfinancial information transfer effects include Bowen et al. (1983), Olsen and Dietrich (1985), and Dranove and Olsen (1994).[1] This study develops the nonfinancial information transfer line of inquiry initiated by these authors and is the first study to use Australian data. We also extend the information transfer literature by focussing on the extractive industry. Work in this area is valuable given the economic significance of the extractive industries in Australia.[2]

[1] Bowen et al. (1983) study the effects of the announcement of the Three Mile Island mishap, Olsen and Dietrich (1985) examine the impact of information transfer between retailers and suppliers following retail sales announcements, and Dranove and Olsen (1994) examine the share price impacts on pharmaceutical companies following firm-specific dangerous drug announcements.

[2] For example, in Australia around the time of the discovery in December 1996, there were 431 listed mining companies out of a total of 1212 listed companies, or 36% of total listed companies were mining companies. This figure excludes all companies in mining services and engineering industries that directly rely on the mining industry for much of their commerce. Source: Who Audits Australia? (Craswell, 1997).

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