The Influence of Celebrity Endorsements on Stock Prices

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Abstract **- Celebrity endorsements have been long been used to promote companies' products and strengthen brands; however, celebrity endorsements can also be linked to an increase in company stock prices. The purpose of this paper is to examine the influence of celebrity endorsements on stock prices. An overview of the theoretical framework of the celebrity will be applied to stock analysts and a review of the abnormal returns of this influence will be presented.**

Keywords *- Marketing, stock-price, investor, celebrity endorsement, efficient market, inefficient market, behavioural finance*.

1. Introduction

In traditional financial theory, capital markets have been regarded as adherent to the *efficient-market hypothesis*. The efficient-market hypothesis assumes a market where all information is available to all investors. When prices reflect this availability, the markets are considered efficient (Fama, 1970). In the efficient-market hypothesis it is stated that investors with a well-diversified portfolio cannot consistently earn more or less relative to the market average (Mayo, 2010). According to the efficient-market hypothesis, investors react so quickly to changes in the news that markets remain efficient; however, based on research, this has not always been the case. The emerging field of behavioral finance has placed this theory and the rationality of investors in question. The argument in behavioral finance is that individual investors make decisions based on heuristics and biases due to limited time and information, and thereby develop shortcuts to making decisions (Ackert & Deaves, 2009, p. 83). Investors who make decisions based on heuristics and biases do not make decisions with all existing information, which leads to anomalies in the market. These anomalies are counterintuitive to the concept of market efficiency (Ackert & Deaves, 2009). Upon study, there are many reasons why these anomalies exist; however, one that has acquired much attention deals with endorsements by Celebrity stock endorsers (Barber, Lehavy, McNichols, & Trueman, 2001; Barber & Loeffler, 1993; Karniouchina, Moore, & Cooney, 2009; Metcalf & Malkiel, 1994; Womack, 1996). With the influence of the Internet, online television, podcasts, and YouTube, individual investors have unprecedented access to information and celebrities and experts can reach a broader audience than ever before. This reach has produced several event-study analyses that show market inefficiency and raise questions regarding the implications of endorsements and stock price returns for companies.

2. Celebrity Endorsements

Celebrity endorsements provide more value than merely attracting customers to products. For example, just the announcement of a celebrity endorsement can result in a rise of a company's stock price. For example, studies have shown when a company announces that a celebrity will speak for their product, an increase in the price of company stock results (Agrawal & Kamakura, 1995). Not only does the increase in stock price occur during the initial announcement, the increase remains in effect for the life of the advertisements or the celebrity's popularity. Celebrity endorsements have offered positive stock returns simply by virtue of the favourable mention of their financial performance. The presumed trustworthiness of endorsers entices investors to purchase the stock without performing due diligence. Marketing executives can use this phenomenon to make brand and advertising decisions and to increase the return on investment of marketing operations for their companies.

Company leaders have long used celebrity endorsements to increase awareness and sales of their products. To understand the effects of celebrity endorsements and advertising, it is important to provide a theoretical framework of the celebrity and the foundational marketing definition. A celebrity is traditionally defined as "a person who is well known by the public" (Friedman & Friedman, 1979, p. 63). This person is usually attractive and/or likeable and may possess some type of expertise or achievement (Kamins, Brand, Hoeke, & Moe, 1989).

Celebrities are used in advertisements because they enhance brand awareness and message recall and produce a higher probability that consumers will buy the product (Agrawal & Kamakura, 1995). A celebrity's achievements and likeability alone will not entice consumers to purchase products. To be effective as a celebrity, and therefore influence stock prices, a celebrity must possess traits that consumer's desire and one of those traits is credibility. There are two models in the literature that focus on the credibility of a celebrity – the source credibility model and the source attractiveness model (Erdogan, 1999).

2.2 Source Credibility and Attractiveness Models

The source credibility model represents someone who has expertise, trustworthiness, and attractiveness (Dholakia & Sternthal, 1977; Doss, 2011; Ohanian, 1991). Expertise "refers to the amount of knowledge that a source is perceived to have about a subject" (Erdogan, 1999, p. 298). Expertise is a key factor in determining the credibility of the celebrity and has been shown to be the most influential aspect of selling to the consumer (Erdogan, 1999). Trustworthiness represents the confidence that consumers place in the celebrity advertisers and whether or not they believe he or she is making valid statements (Amos, Holmes, & Strutton, 2008; Ohanian, 1990).

Amos et al. (2008) concluded that the trustworthiness of the celebrity is the most effective part of the source credibility model and with advertisements featuring celebrities as a whole. The source attractiveness model integrates neatly into the source credibility model. The overlapping factor in the two models is attractiveness (Ohanian, 1990). It is important to note that attractiveness does not mean just the physical aspect of the celebrity advertiser. Attractiveness also represents the celebrity's familiarity and likeability (Erdogan, 1999). When analyzing the effect of celebrity endorsements on the price of stocks, it is important that the endorser represent all three traits in the source credibility model to be effective. For many individual investors, the endorser of stocks may be the only source he or she uses for stock purchase information for retirement funds or other important monetary aspects of their life and credibility is an important factor in making those decisions.

The celebrity endorser is represented in three main personas: (a) the spokesperson, (b) the endorser, and (c) the testifier (Erdogan, 1999). An overview of the personas will be provided with a focus on a professional expert. A spokesperson or testimony by a celebrity is generally not going to appeal to someone who is purchasing stocks. It is critical that the endorser of the purchase be an expert in his or her field with experience of stock purchases. In the case of these stock purchases, the most influential celebrity will be the professional expert endorser. The professional expert endorser is "an individual or group possessing superior knowledge regarding the product class endorsed and (who) has obtained this knowledge as a result of experience, study, and training" (Kamins et al., 1989, p. 63). Because the purpose of this study is to look at financials, it is important to note that researchers have found that experts perform better for products with high financial performance and therefore are the most relevant for this review (Friedman & Friedman, 1979).

2.3 Celebrity Stock Endorsers

One of the most popular celebrity endorsers of stocks is Jim Cramer. Cramer is the host of *Mad Money* on CNBC. More than 250,000 viewers watch *Mad Money* each day (Karniouchina et al., 2009, p. 245). Cramer's show is described as a mix of "professional wrestling, infomercial, pitching, and hyperkinetic game shows, all the while dispensing stock tips to the couch potato investors" (Becker, 2005, p. 10). Cramer's dynamic show attracts many rookie investors who look to him for recommendations. Neumann and Kenny (2007) described Cramer as "a man who blurs the line between creating business news and covering it" (p. 603). Cramer has critics and may not be appropriate for all investors; however, for the many people who watch his show, there is no doubting the influence that he holds (Lawler, 2009).

Cramer has source credibility and can easily be categorized as a professional expert. Cramer is a graduate of Harvard College and a former hedge fund manager at Cramer Berkowitz. During his tenure as senior partner, he amassed a 24% rate of return for 15 years (Kadlec, 2002) As far as trustworthiness goes, Cramer does not invest his own money and therefore does not directly profit from the recommendations he makes. Cramer holds a charitable trust and does not have to make any disclosures when recommending stocks to individual investors except that it is held by his charitable trust. Knowing that Cramer is not making money for himself may entice individual investors to trust him without inhibition.

In addition to television show hosts like Jim Cramer, other popular stock analysts must be considered as celebrity endorsers. One of the most popular and widely used stock analysts are The Motley Fools, whose website has been described as "the most popular internet stock chat website" (Giacomino & Akers, 2011, p. 37). The Motley Fools website often provides information that is "contradictory to academics, often makes mistakes, and should be critically evaluated" (Giacomino & Akers, 2011, p. 44). However, even though this information is well known, The Motley Fools and their recommendations affect the stock market just as much as Jim Cramer and other analyst's recommendations (Giacomino & Akers, 2011, p. 44).

It is interesting to note that the mission statements of Jim Cramer and of The Motley Fools are very similar. Cramer states that he wants to "educate people, entertain people, and help them make money" (Becker, 2005, p. 10). The Motley Fools mission statement says that they are "here to educate, amuse, and enrich" (Giacomino & Akers, 2011, p. 37). These mission statements have entertainment and influence as core values. If the efficient-market hypothesis was completely valid and investors only bought and sold stocks based on effective financial evaluations of financial performance, then the financially unrelated investment advice and entertainment value of Cramer and The Motley Fools would have no weight in the capital markets; however, event studies show otherwise.

3. Event Study Analysis

3.2 Mad Money

An event study analysis is critical in determining the celebrity endorsement effect of Jim Cramer on the efficient-market hypothesis. An event study focuses on variables that occur during a specified period of time. In the past, event study analyses have been used to analyze what type of effect events have on profitability (Agrawal & Kamakura, 1995). Results from event analysis indicate that celebrity endorsements have positive effects on the return of stock prices around the day of endorsement. (Agrawal & Kamakura, 1995).

The three event studies analyzed for Jim Cramer all show similar results: an increase in volume of shares traded after Cramer's recommendations and abnormal stock returns greater than 1.00% that decrease back to normal levels over time (Karniouchina et al., 2009; Neumann & Kenny, 2007). Neumann and Kenny (2007) analyzed 216 recommendations by Jim Cramer from July 26, 2005 to September 9, 2005. During the first trading day after a buy recommendation aired, "abnormal returns of 1.06%, 1.09%, and 1.00% relative to the market model, CRSP index, and historical mean (were) realized" (Neumann & Kenny, 2007, p. 605). In addition, the estimated volume for the particular stocks increased by 27.78% the day after the show date, suggesting abnormal buying and selling after mentioning them on his show (Neumann & Kenny, 2007). Engleberg, Sasserville, and Williams (2006) found similar results in their event study of 246 initial recommendations given by Cramer between July 28, 2005 and October 10, 2005 (p. 2). The cumulative abnormal return for the study was 6.71% for its value three days before the recommendation and 1.96% overnight (Engleberg et al., 2006, p 2). A turnover ratio was also computed in the study showing that the volume of shares traded of "smaller firms is 317% of its typical size the day of recommendation, 890% the day following recommendation, and 451% on the second day following the recommendation" (Engleberg et al., 2006, p. 7). Karniouchina et al. (2009) also showed abnormal returns of 1.07% and 1.23% on the opening and closing sections of the show (p. 251). The event studies all portray the increased volume and abnormal returns of the stock picks of Jim Cramer.

When looking at Jim Cramer as a celebrity and professional expert, it is apparent that even though his show is not an advertisement, it is definitely persuasive and is lacking ambiguous statements normally involving stock picks (Karniouchina et al., 2009). Contrary to an advertisement where individuals watch paid promotions, people watching Jim Cramer's show are actively looking for recommendations (Karniouchina et al., 2009). Cramer's expertise as a celebrity is a reflection of his track record. Even though Cramer is not trying to sell anything, his track record is important to his career as a stock analyst (Karniouchina et al., 2009). It is because of this endorsement and professional value offered to naïve investors that abnormal returns occur after his recommendations.

3.3 Analyst Recommendations

According to Barber and Odean (2008), investors are more likely to buy rather than sell stocks that catch their attention (Barber & Odean, 2008). With the explosion of information available on the Internet, it has become increasingly easy for stocks to catch the attention of investors. When analysts such as The Motley Fools change recommendations, they advertise them publicly and investors are able to buy or sell, reacting to them immediately (Barber et al., 2001). Analyst recommendations are key determinants of trading volume from day to day. Investors react to changes in recommendation by security analysts at the end of the trading day (Barber et al., 2001). Abnormal gross returns from analyst recommendations are on average 4.13% for buy recommendations and 4.91% for the sell recommendations (Barber et al., 2001, p. 561)

One of the most famous studies of analyst recommendations occurred with the very popular "Dartboard" column of *The Wall Street Journal*. In the study by Barber and Loeffler (1993), stocks picked in the "Dartboard" column by professional experts of *The Wall Street Journal* earned abnormal returns of 4% and abnormal volume for six days after the picks appeared in the column (Barber & Loeffler, 1993, p. 277). In addition, one of the most famous analysts, The Motley Fools, also shows abnormal volume and returns. When The Motley Fools announce a buy recommendation there is an average price increase of $3.36 to $3.72 per share and during the three day period following there is an average increase of $6.08 to $6.87 per share. In addition, there is a 126.53% increase in the volume of trades during an announcement, followed by a 114.43% increase the day after (Hirschey, Richardson, &

Scholz, 2000, p. 68). This reinforces the belief that analyst's recommendations influence the buying behavior of investors. The research suggests that investors fail to do their due diligence when they purchase stocks and instead follow the patterns of celebrity endorsements by Jim Cramer and other popular analysts.

3.4 Marketing Strategy

Investors seem to be looking to take shortcuts when it comes to investing in stocks. The heuristics involved show that many investors fail to do their own research when it comes to stock picks. These shortcuts using the recommendations of Jim Cramer, The Motley Fools, and other analysts provide an astonishing opportunity for marketing executives. First, attention grabbing analysts and news stories seem to produce abnormal stock returns. It is the individual investors and not institutional investors who are the most susceptible to purchasing stocks that grab attention and produce news (Barber & Odean, 2008). Marketing executives could monitor these shows and analyst recommendations for opportunities to sell products to investors.

One factor being studied is the effect that ownership of a company stock leads to the purchase of company products (Aspara & Tikkanen, 2008; Frieder & Subrahmanyam, 2005). There is evidence that the investors may buy the products of companies because they are a stock owner (Aspara & Tikkanen, 2008). In traditional consumer behavior, the positive attitude a person has about a company influences their purchases (Aspara & Tikkanen, 2008). Consumers are influenced on stock ownership and product purchases because the stock has personal relevance to them and the company's brand (Aspara & Tikkanen, 2010).

Aspara and Tikkanen (2010) found that consumers manifest the personal relevance of a product purchase in two ways. First, if a consumer is evaluating two different stocks and they both have the same financial returns and risks, the consumer will be more willing to invest in the one that is personally relevant. Second, if a stock purchase is not producing the returns expected, a consumer may be more willing to deal with the low financial returns of a stock in which the consumer has no personal relevance (Aspara & Tikkanen, 2010). According to the survey sent out in the study, only 14.3% of the respondents stated that they did not care which stock to invest in if both had similar financial returns and risk; accordingly, 85.7% of the respondents were willing to invest in a stock for a reason beyond its expected financial returns (Aspara & Tikkanen, 2010, p. 21).

From the research of stock purchases and celebrity endorsements, it is apparent that investors make decisions for reasons other than financial returns. There are some heuristics and biases that arise from investing and research shows that anomalies exist and challenges to the efficient-market hypothesis are evident. Marketing executives can use this information to promote products and even their stock in new ways. First, marketing executives can identify domains the company's product represent and then target customers' personal relevance of the company (Aspara & Tikkanen, 2010). Second, companies could place reminders on packaging or messaging related to investing in the company. Significant partnerships with an online broker could increase the reach for the company and the broker. Third, companies could market products to buy and stock to invest in. They could accomplish this through shareholder advertising and promotion to customers who already own company stock (Aspara & Tikkanen, 2010). Celebrity endorsers could provide the avenue through which to communicate these strategies to customers.

Following the marketing framework segmentation, targeting, and positioning, a plan could be developed using celebrity endorsers and investors. The segmentation of the market represents a group of customers who own the stock of a corporation. Studies could be done to analyze whom this market represents and products could be marketed directly to shareholders through the annual report or other avenues. Using the demographics of the shareholders, companies could target specific populations with specific products that a company could develop. The *hybrid marketing* concept of selling not only stock but also products to the consumer could produce a target audience that companies do not normally serve and may produce a form of brand loyalty to the products and the stock. Finally, a company could position itself to offer products just to the investor. The opportunity to market to these investors could open up a new product or product line when dealing with these implications. A celebrity endorser could be used to introduce this information to customers. Sponsorship on shows such as Mad Money and analyst recommendation sites offering discounts to shareholders on products advertised by the endorsers open the door for company leaders to develop strategies for stock price and brand loyalty.

4. Conclusion

The efficient-market hypothesis remains a long-standing theory on how capital markets operate. Though regarded by many as fact, the literature examining the decisions based on analyst recommendations and famous celebrity endorsers brings to the surface doubts regarding an efficient market. There is a psychological process involved in choosing investments and companies can analyze the decision making process to market products and stock purchases to shareholders and future shareholders. Further research needs to be completed regarding this literature. It is important to understand how widespread the effects of recommendation

changes are and the possibilities of using them for *hybrid marketing* strategies of stock purchases and product purchases. In addition, could the benefit of running ads with positive analyst recommendations, or placing a celebrity stock analyst in a commercial for the companies, increase not only the brand purchase but also the ownership in the company's stock? To further research the phenomenon that occurs with celebrity endorsements and stock prices, a correlation could be conducted between the two variables using larger than a three-month sample size. This would help to establish that this was a consistent anomaly in the capital market. In addition, more analyst and television stock advice could be analyzed to determine exactly what type of celebrity endorsement credibility and trustworthiness is required to produce these anomalies in stock prices.

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