

Universität Mannheim  
Lehrstuhl für Internationale Finanzierung  
68131 Mannheim

**Besucheradresse:**  
L9, 1-2  
68161 Mannheim  
Telefon 0621/181-3755  
Telefax 0621/181-1664

Nic Schaub  
schaub@bwl.uni-mannheim.de  
<http://intfin.bwl.uni-mannheim.de>

## Master Thesis HWS 2014

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- Topic R1:**     **The Nominal Price Puzzle – International Evidence**  
Advisor: Michael Ungeheuer
- Topic R2:**     **Prospectus Language and IPOs**  
Advisor: Paris Tsotsonos
- Topic R3:**     **Are IPO Phenomena Stable? An Examination of IPO Waves, First-day Returns, and Long-run Performance after the Internet Bubble**  
Advisor: Paris Tsotsonos
- Topic R4:**     **Going Down the Income Statement to Explain the Cross Section of Stock Returns**  
Advisor: Lena Jaroszek
- Topic R5:**     **Advertising and Media Coverage of the Dangers of Alcohol Abuse**  
Advisor: Florens Focke
- Topic R6:**     **Advertising and Media Coverage of Climate Change**  
Advisor: Florens Focke
- Topic R7:**     **Performance of Mutual Funds and Smart Money Effect in Europe**  
Advisor: Pavel Lesnevski
- Topic R8:**     **Mutual Fund's  $R^2$  as Predictor of Performance**  
Advisor: Pavel Lesnevski



## Topic R1: The Nominal Price Puzzle – International Evidence

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**Classification:** Empirical topic

**Advisor:** Michael Ungeheuer

Since 1933, average share prices on the NYSE and AMEX have fluctuated between \$20 and \$35 (Weld et al., 2009). During the same time average consumer prices experienced a more than 17-fold increase. This remarkable decoupling of nominal share prices from inflation is an effect of stock splits: Without any stock splits since 1976, average share prices would be more than 25 times higher today (Dyl and Elliott, 2006). Stock splits are costly: Direct administrative costs for a split of a large firm are estimated to be between \$250,000 and \$800,000. So what could explain the frequent stock splits towards a stable *nominal* price-range? Several explanations have been brought forward, e.g.:

- Managers may try to signal undervaluation by splitting.
- Liquidity (relative spreads and trading commissions) could be higher at certain prices.
- Managers could use price levels to attract specific investors (retail vs. institutional).
- Irrational preferences for certain price ranges by some investors may impact the cost of capital and thus lead managers to cater to these investors by splitting (Baker et al., 2009).
- Adherence to social norms, i.e. the arbitrary following of conventions by managers, could be a cause for stock splits (Weld et al., 2009).

There are several studies that discuss and test these explanations. These studies use mainly U.S. data (exception: Weld et al., 2009 have a short section on international evidence) and usually focus on one of the above explanations.

The goal for this master thesis is to first replicate and consolidate the general results found for the U.S. stock market until 2007. Second, the analysis should be extended to include the financial crisis. Third, data for international stock markets (obtainable through Datastream) should be used to test the above theories out-of-sample.

### Requirements:

The empirical work for this topic requires the use of statistical software (e.g. Stata), manipulation of data and the application of econometric methods. Some experience in this area would be helpful.

### Introductory Literature:

Baker, M.; Greenwood, R.; Wurgler, J. (2009): Catering through Nominal Share Prices, *Journal of Finance*, 64, pp. 2559-2590.

Dyl, E.A.; Elliott, W.B. (2006): The Share Price Puzzle, *Journal of Business*, 79, pp. 2045-2066.

Green, T.C.; Hwang, B. (2009): Price-based return comovement, *Journal of Financial Economics*, 93, pp. 37-50.

Weld, W.C.; Michaely, R.; Thaler, R.H.; Benartzi, S. (2009): The Nominal Share Price Puzzle, *Journal of Economic Perspectives*, 23, pp. 121-142.

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## Topic R2: S-1 Prospectus Language and IPOs

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**Classification:** Empirical topic

**Advisor:** Paris Tsotsonos

A recent focus in empirical corporate finance lies on analyzing text in a financial context. For instance, Tetlock (JF, 2007) analyzes a popular Wall Street Journal column, and finds that the use of negative, pessimistic language predicts downward short-term buying pressure on stock prices. Analyzing 10-K filings, Loughran and McDonald (JF, 2011) find that language is linked to firms' fundamentals.

In the context of initial public offerings (IPOs), Hanley and Hoberg (RFS, 2010) show that greater informative content in the prospectus can serve as a substitute for costly information production by the underwriter during the bookbuilding process. In a similar paper, Loughran and McDonald (JFE, 2013) find that negative prospectus tone reflects uncertainty surrounding the offering, and predicts upward pressure on offer price revisions and first-day returns.

The goal of this thesis is to (1) review and illustrate the existing relevant literature on textual analysis in a financial context, and (2) conduct an own empirical study on the effect of prospectus language on IPOs. As a start, the study of Loughran and McDonald (JFE, 2013) should be (partly) replicated.

All relevant databases (SDC, CRSP, and COMPUSTAT, among others) are accessible at the University of Mannheim. IPO prospectuses are provided by the SEC EDGAR system, and can be downloaded online. We offer a quick textual analysis program to classify prospectus tone.

### Requirements:

A sound knowledge in corporate finance is needed for this topic. Basic knowledge (or ability/willingness to acquire basic knowledge) in econometrics and STATA is required. Furthermore, a relatively simple web-crawling program will have to be programmed in order to collect and clean SEC filings.

### Introductory Literature:

Hanley, K. W. and G. Hoberg (2010). The Information Content of IPO Prospectuses. *Review of Financial Studies* 23 (7), 2821-2864.

Loughran, T. and B. McDonald (2011). When Is a Liability Not a Liability? Textual Analysis, Dictionaries, and 10-Ks. *Journal of Finance* 66 (1), 35-65.

Loughran, T. and B. McDonald (2013). IPO first-day returns, offer price revisions, volatility, and form S-1 language. *Journal of Financial Economics* 109, 307-326.

Tetlock, P. C. (2007). Giving Content to Investor Sentiment: The Role of Media in the Stock Market. *Journal of Finance* 62 (3), 1139-1168.

### Topic R3: Are IPO Phenomena Stable? An Examination of IPO Waves, First-day Returns, and Long-run Performance after the Internet Bubble

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**Classification:** Empirical topic

**Advisor:** Paris Tsotsonos

Ritter and Welch (JF, 2002) report three major phenomena for initial public offerings (IPOs): First, IPOs occur in waves, with times where many companies seemingly go public at the same time, creating a so-called “hot market”, and other times with very low IPO activity. Second, IPOs are underpriced, resulting in large first-day returns, on average. Third, IPO stocks underperform the market and comparable firms or portfolios of comparable firms in the long-run.

However, most of the theoretical and empirical work on these phenomena was conducted in the 1980s and 90s. After the burst of the Internet bubble in 2000/2001, there are significantly less firms going public in the U.S. compared to previous decades. In addition, average first-day returns seem to be smaller as well. This raises the question whether the above described phenomena are stable, and whether previous empirical results hold for the time period after 2001. In addition, information production and marketing of the offering conducted by underwriters has changed with the use of Internet as a major source of information for investors.

The goal of this thesis is to (1) review and illustrate the existing relevant literature IPO waves, first-day returns, and long-run performance, and (2) conduct an own empirical study for U.S. IPOs, examining whether empirical findings in prior literature hold for the recent time period.

All relevant databases (SDC, CRSP, and COMPUSTAT, among others) are accessible at the University of Mannheim. Additional information and data can be found on Jay Ritter’s website.

#### **Requirements:**

A sound knowledge in corporate finance is needed for this topic. Basic knowledge (or ability/willingness to acquire basic knowledge) in econometrics and STATA is required.

#### **Introductory Literature:**

Loughran, T. and J. R. Ritter (2002). Why Don't Issuers Get Upset About Leaving Money on the Table in IPOs? *Review of Financial Studies* 15 (2), 413-443.

Lowry, M. and G. W. Schwert (2002). IPO Market Cycles: Bubbles or Sequential Learning? *Journal of Finance* 57 (3), 1171-1198.

Lyon, J. D., B. M. Barber, and C.-L. Tsai (1999). Improved Methods for Tests of Long-Run Abnormal Stock Returns. *Journal of Finance* 54 (1), 165-201.

Ritter, J.R., and Welch, I. (2002): A Review of IPO Activity, Pricing, and Allocations, *Journal of Finance* 57, 1795-1828.

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**Topic R4: Going Down the Income Statement to Explain the Cross Section of Stock Returns**

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**Classification:** Empirical topic

**Advisor:** Lena Jaroszek

Recently, Novy-Marx (2013) established gross profits as an accounting measure for economic profitability in order to explain the cross section of stock returns. He motivates this empirical proxy for productivity by arguing that profitability measures farther down the income statement become more polluted due to managerial discretion, and that they are therefore less related to true economic profitability. For example, if the firm spends on research and development to increase its production advantage or invests in organizational capital that helps it maintaining its competitive advantage, these actions result in lower current earnings. Moreover, capital expenditures that directly increase the scale of the firm's operations further reduce its free cash flows relative to its competitors. Some of these items have already been identified in earlier studies in empirical asset pricing. Long established are findings like those of Sloan (1996) which focus on the role of accruals to predict returns. Also, Chan, Lakonishok, and Sougiannis (2001) argue that research and development and advertising expenditures also have explanatory power in the cross section of stock returns. The aim of this master thesis is to replicate in a first step the studies at hand. Secondly, it should be examined whether stock returns can also be predicted by other individual components from the difference between gross profits and earnings (such as taxes paid or discontinued operations) or an aggregate measure considering the components which are found to have predictive power.

**Requirements:**

We expect the candidate to show a sound knowledge of the theory of asset pricing, accounting and econometrics. The empirical work requires the use of CRSP and Compustat databases (access will be provided). We recommend that the candidate feel comfortable in the use of a statistical software program (such as Stata).

**Introductory Literature:**

Novy-Marx, R. (2013): The other side of value: The gross profitability premium, *Journal of Financial Economics*, 108, pp. 1-28.

Chan, L.K.C.; Lakonishok, J.; Sougiannis, T., (2001): The stock market valuation of research and development expenditures, *Journal of Finance*, 56, pp. 2431–2456.

Sloan, R.G. (1996): Do stock prices fully reflect information in accruals and cash flows about future earnings?, *Accounting Review*, 71, pp. 289–315.

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### Topic R5: Advertising and Media Coverage of the Dangers of Alcohol Abuse

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**Classification:** Empirical topic

**Advisor:** Florens Focke

The media is an important source of information, both for investors and for consumers. According to the Newspaper Association of America (NAA), 70% of American adults access content from newspaper media each week. In doing so, they rely on the accuracy and objectivity of the information. However, many news outlets including most newspapers, magazines and TV channels are financed in a large part by advertising. For U.S. newspapers, the NAA states that about 70% of revenues are generated by advertising so that only 30% come from circulation. Therefore, it is possible that media outlets are reluctant to 'bite the hand that feeds them' and report overly favorably about their advertising clients or issues important to those.

Companies can be affected by overly positive reporting in several ways. One is the effect it may have on consumers, who may be more likely to purchase a company's product if it is positively covered in the press. Another is the effect on investors. Being presented excessively favorable information on the firm, investors may fail to correctly infer the company's current financial situation or potential dangers to the future sales of its products.

Theoretical analyses suggest that these effects might be particularly relevant in situations where companies in an industry share a common interest (Ellman and Germano 2009; Blasco and Sobbrío 2012). Prior research has studied the influence of the Tobacco industry in suppressing information on the dangers of smoking (e.g., Baker 1994). Another such situation could be the dangers of alcohol abuse, which alcohol producers have an interest to downplay.

The purpose of this study is to investigate the potential influence of advertising by alcohol producers on the coverage of the dangers of alcohol abuse in the news media. A database of advertising spending in U.S. news outlets will be provided. The student should identify suitable search phrases or subject codes to obtain articles covering alcohol abuse from LexisNexis. In a first step, the number of articles mentioning problems associated with the consumption of alcohol that appear in a given news outlet should be considered. Building on this, the analysis should be extended by using the word lists provided by the Harvard-IV dictionary. Finally, a word list specific to the context could be developed to measure the usage of words linked with alcohol abuse (e.g., "addiction"). The student should then test whether advertising spending is associated with these different measures of media coverage of alcohol abuse.

#### Requirements:

The empirical work requires the use of textual analysis. While the necessary program to perform the analysis will be provided, prior knowledge (or ability/willingness to acquire such knowledge) in the computational analysis of text is important. Furthermore, basic knowledge (or ability/willingness to acquire basic knowledge) in econometrics and STATA is required.

#### Introductory Literature:

Reuter, Jonathan, and Eric Zitzewitz, 2006, Do ads influence editors? Advertising and bias in the financial media, *The Quarterly Journal of Economics*, 197–227.

Baker, Edwin C., 1994, *Advertising and a Democratic Press* (Princeton University Press, Princeton).

Blasco, Andrea, and Francesco Sobbrío, 2012, Competition and commercial media bias, *Telecommunications Policy* 36, 434–447.

Ellman, Matthew, and Fabrizio Germano, 2009, What do the papers sell? a model of advertising and media bias, *The Economic Journal* 119, 680–704.

Gurun, Umit G., and Alexander W. Butler, 2012, Don't Believe the Hype: Local media slant, local advertising, and firm value, *Journal of Finance* 67, 561–597.

Reuter, Jonathan, 2009, Does Advertising Bias Product Reviews? An Analysis of Wine Ratings, *Journal of Wine Economics* 4, 125–151.

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## Topic R6: Advertising and Media Coverage of Climate Change

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**Classification:** Empirical topic

**Advisor:** Florens Focke

The media is an important source of information, both for investors and for consumers. According to the Newspaper Association of America (NAA), 70% of American adults access content from newspaper media each week. In doing so, they rely on the accuracy and objectivity of the information. However, many news outlets including most newspapers, magazines and TV channels are financed in a large part by advertising. For U.S. newspapers, the NAA states that about 70% of revenues are generated by advertising so that only 30% come from circulation. Therefore, it is possible that media outlets are reluctant to 'bite the hand that feeds them' and report overly favorably about their advertising clients or issues important to those.

Companies can be affected by overly positive reporting in several ways. One is the effect it may have on consumers, who may be more likely to purchase a company's product if it is positively covered in the press. Another is the effect on investors. Being presented excessively favorable information on the firm, investors may fail to correctly infer the company's current financial situation or potential dangers to the future sales of its products.

Theoretical analyses suggest that these effects might be particularly relevant in situations where companies in an industry share a common interest (Ellman and Germano 2009; Blasco and Sobbrío 2012). Prior research has studied the influence of the Tobacco industry in suppressing information on the dangers of smoking (e.g., Baker 1994). Another such situation could be the possibility of a change in global climate as well as the dangers posed by such a change. Carbon-dioxide intensive industries such as automobile or air transport might have an incentive to downplay these issues.

The purpose of this study is to investigate the potential influence of advertising by these two industries on the coverage of climate change in the news media. A database of advertising spending in U.S. news outlets will be provided. The student should identify suitable search phrases or subject codes to obtain articles covering climate change from LexisNexis. In a first step, the number of articles discussing climate change that appear in a given news outlet should be considered. Building on this, the analysis should be extended by using the word lists provided by the Harvard-IV dictionary. Finally, a word list specific to the context could be developed to measure the usage of words linked with climate change (e.g., "carbon"). The student should then test whether advertising spending is associated with these different measures of media coverage of climate change.

### Requirements:

The empirical work requires the use of textual analysis. While the necessary program to perform the analysis will be provided, prior knowledge (or ability/willingness to acquire such knowledge) in the computational analysis of text is important. Furthermore, basic knowledge (or ability/willingness to acquire basic knowledge) in econometrics and STATA is required.

### Introductory Literature:

Reuter, Jonathan, and Eric Zitzewitz, 2006, Do ads influence editors? Advertising and bias in the financial media, *The Quarterly Journal of Economics*, 197–227.

Baker, Edwin C., 1994, *Advertising and a Democratic Press* (Princeton University Press, Princeton).

Blasco, Andrea, and Francesco Sobbrío, 2012, Competition and commercial media bias, *Telecommunications Policy* 36, 434–447.

Boykoff, M. T., & Boykoff, J. M., 2004, Balance as bias: Global warming and the US prestige press, *Global Environmental Change*, 14, 125–136.



Ellman, Matthew, and Fabrizio Germano, 2009, What do the papers sell? a model of advertising and media bias, *The Economic Journal* 119, 680–704.

Gurun, Umit G., and Alexander W. Butler, 2012, Don't Believe the Hype: Local media slant, local advertising, and firm value, *Journal of Finance* 67, 561–597.

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## Topic R7: Performance of Mutual Funds and Smart Money Effect in Europe

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**Classification:** Empirical topic

**Advisor:** Pavel Lesnevski

Starting with Jensen (1968) many studies have shown that on average actively managed mutual funds underperform their relevant benchmarks after fees. As a result a natural question arises: Why do investors trust their capital to actively managed mutual funds? To answer this question Gruber (1996) proposes a simple testing procedure. He argues that there is heterogeneity in the skills of fund managers and that at least some investors are able to identify superior fund managers. In this case capital flows to mutual funds should be able to positively forecast future fund performance. The author and a follow-up study by Zheng (1999) find supportive results for this smart money hypothesis in the US. However, Sapp and Tiwari (2004) show that after accounting for the momentum anomaly (i.e. that past winner stocks outperform past loser stocks) the smart money effect disappears. Consistent with this result, Ferreira et. al. (2013) find no evidence for the smart money effect in the US. However, they do find that it is present in the non-US funds around the world. Gharghori et. al. (2007) and Keswani and Stolin (2008) find similar results for Australia and UK respectively.

The goal for this master thesis is to first replicate the findings of earlier studies on fund underperformance and the smart money effect in the US. However, the main contribution of the thesis should be to test whether investors in Europe distinguish good managers from bad ones. The result that funds with positive net inflows subsequently perform significantly better than funds that experience net outflows along the lines of Sapp and Tiwari (2004) would serve as evidence in favor of this hypothesis. In the context of the thesis, an appropriate benchmark model for European mutual funds should be developed.

All relevant databases (Morningstar, Kenneth French Library) are accessible at the University of Mannheim.

### Requirements:

The empirical work for this topic requires the use of statistical software (e.g. Stata), manipulation of data and the application of econometric methods. Some experience in this area would be helpful.

### Introductory Literature:

Ferreira, Miguel A., Aneel Keswani, António F. Miguel, and Sofia B. Ramos. "The Determinants of Mutual Fund Performance: A Cross-Country Study." *Review of Finance* 17, no. 2 (April 1, 2013): 483–525. doi:10.1093/rof/rfs013.

Gruber, Martin J. "Another Puzzle: The Growth in Actively Managed Mutual Funds." *Journal of Finance* 51, no. 3 (July 1996): 783–810.

Khorana, Ajay, Henri Servaes, and Peter Tufano. "Explaining the Size of the Mutual Fund Industry around the World." *Journal of Financial Economics* 78, no. 1 (October 2005): 145–85. doi:10.1016/j.jfineco.2004.08.006.

Sapp, Travis, and Ashish Tiwari. "Does Stock Return Momentum Explain the 'Smart Money' Effect?" *The Journal of Finance* 59, no. 6 (2004): 2605–22. doi:10.1111/j.1540-6261.2004.00710.x.

Zheng, Lu. "Is Money Smart? A Study of Mutual Fund Investors' Fund Selection Ability." *The Journal of Finance* 54, no. 3 (June 1, 1999): 901–33.

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**Topic R8: Mutual Fund's  $R^2$  as Predictor of Performance**

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**Classification:** Empirical topic

**Advisor:** Pavel Lesnevski

Recent papers by Kacperczyk, Sialm and Zhen (2005) and Cremers and Petajisto (2009) suggest that active management, measured as deviation of fund's portfolio from benchmark portfolio, is an indicator of a mutual fund manager's skill and a good predictor of future fund performance. But their approach is associated with practical difficulties for investors. Firstly, it requires information on portfolio holdings which is reported quarterly and is not always readily available. Secondly, many fund benchmark index are not always known. Thus, Amihud and Goyenko (2013) develop an alternative intuitive and easy to obtain proxy. It is equal to  $1 - R^2$  estimated by regressing a fund's returns on the returns of a benchmark multifactor model. The authors argue that this proxy reflects the share of fund return variance that is due to factors that are not explained by factors in a benchmark model. If this variance is due to selectivity than it should positively predict fund's performance. They show that this is the case for the US mutual fund industry.

The goal of the master thesis is to first replicate the results of Amihud and Goyenko (2013) for the US and, possibly, to extend the study to the European fund industry. In this case the student is expected to design relevant sets of benchmark models (see Fama and French, 2012; Ferreira et. al., 2013) and to test the relation between  $R^2$  and a fund's alpha. Alternatively, one might elaborate on the comprehensive analysis of the new proxy in the US sample.

All relevant databases (Morningstar, Kenneth French Library) are accessible at the University of Mannheim.

**Requirements:**

The empirical work for this topic requires the use of statistical software (e.g. Stata), manipulation of data and the application of econometric methods. Some experience in this area would be helpful.

**Introductory Literature:**

Amihud, Yakov, and Ruslan Goyenko. "Mutual Fund's  $R^2$  as Predictor of Performance." Review of Financial Studies 26, no. 3 (March 1, 2013): 667–94. doi:10.1093/rfs/hhs182.

Cremers, K. J. Martijn, and Antti Petajisto. "How Active Is Your Fund Manager? A New Measure That Predicts Performance." Review of Financial Studies 22, no. 9 (September 1, 2009): 3329–65. doi:10.1093/rfs/hhp057.

Fama, Eugene F., and Kenneth R. French. "Size, Value, and Momentum in International Stock Returns." Journal of Financial Economics 105, no. 3 (September 2012): 457–72. doi:10.1016/j.jfineco.2012.05.011.

Ferreira, Miguel A., Aneel Keswani, António F. Miguel, and Sofia B. Ramos. "The Determinants of Mutual Fund Performance: A Cross-Country Study." Review of Finance 17, no. 2 (April 1, 2013): 483–525. doi:10.1093/rof/rfs013.

Kacperczyk, Marcin, Clemens Sialm, and Lu Zheng. "On the Industry Concentration of Actively Managed Equity Mutual Funds." The Journal of Finance 60, no. 4 (August 1, 2005): 1983–2011. doi:10.1111/j.1540-6261.2005.00785.x.

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