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Consumer Animosity in Financial Markets

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CONSUMER ANIMOSITY IN FINANCIAL MARKETS

ABSTRACT

Social norms are known to be influential on investors, and they sometimes even override profit motives. Literature suggests that despite their performance, “sin stocks” are less preferred by institutional investors and covered less by analysts even though they outperform other stocks. In other words, investors pay premiums not to commit any sins. This study takes a similar approach and argues that nationalistic feelings and animosity toward a particular country can also have similar effects on stock markets. Given the ongoing tensions between China and the United States, it is examined whether Chinese firms trading in US stock markets display patterns similar to sin stocks. It is expected that Chinese firms will suffer from significant discrimination in cases of institutional ownership, analyst coverage, firm valuation and corporate financing. This paper is a work in progress, and the author welcomes any support for data collection.

1. INTRODUCTION

Social norms are very influential on economic behavior (Kempf and Osthoff, 2007; Derwall *et al.*, 2011) and market outcomes (Al-Awadhi and Dempsey, 2017), even overriding profit motives occasionally (Hong and Kacperczyk, 2009). Investors may simply like or dislike certain stocks (Fabozzi *et al.*, 2008), and disliked stocks are expected to provide a higher rate of return (Statman *et al.*, 2008). Since traditional finance models often fail to incorporate subjective feelings, new models incorporating feelings are proposed (Statman, 1999). As shown in the "sin stock" literature, corporates serving in "sin industries" such as tobacco, alcohol, gambling and birth control products are less preferred by institutional investors and covered less by analysts, although these companies have better financial reporting (Kim and Venkatachalam, 2011) and are often over performing the market (Fabozzi *et al.*, 2008; Liston, 2016) in the United States. This phenomenon is also observed in the European (Salaber, 2007) and Asian stock markets (Visaltanachoti *et al.*, 2011). In other words, investors are paying a price in order not to commit "sin" in a global scale.

The sin stocks literature inspires another question: If a religious construct like sin plays such a role, is it possible that nationalistic feelings such as animosity can also play a similar role? In other words, are investors and analysts who are not willing to disobey the will of God(s) also following a similar pattern for their country? Consumer animosity is a special variant of the country-of-origin effect (nationality bias) where consumers have an animosity toward products from a certain country beyond ethnocentrism, independent of product quality (Klein *et al.*, 1998). In their study, Klein *et al.* (1998) found that although Chinese consumers in Nanjing appreciate Japanese brands such as Sony as high-end and high quality, they are not willing to buy a Japanese

product. While consumer animosity is extensively studied in the international marketing literature, no studies have been carried out in the international finance literature.

Relations between the United States and China have become increasingly tense in the 21st century and are moving toward a second cold war. Most Americans have negative feelings toward China, and believe that the US government should be tougher against China, and fittingly,limiting China's power is a top policy preference for them. (Silver *et al.*, 2021). In this study, by examining the Chinese stocks traded in Dow Jones, S&P 500 and NASDAQ between 2010 and 2020, it is hypothesized that animosity toward China has an impact on the stocks of Chinese companies listed in the US, parallel to sin stocks. It is hypothesized that Chinese companies will be held to different standards in cases of institutional ownership, analyst coverage, firm valuation and corporate financing compared to American companies and those from other emerging countries. Data, methodology, limitations and directions for further studies are provided in the following sections.

2. THEORETICAL BACKGROUND

2.1 Consumer Animosity

Consumer animosity is the remnants of antipathy related to previous or ongoing military, political or economic events (Klein *et al.*, 1998). These events could be territory disputes, economic arguments, diplomatic disagreements or religious conflicts (Riefler and Diamantopoulos, 2007). Sales of the firms are impacted negatively due to anger towards their home countries (Klein 2002; Ang *et al.*, 2004; Nijssen and Douglas, 2004). Until Klein *et al.* (1998), classical wisdom assumed that the country of origin has an indirect effect on customers' willingness to buy foreign products via perceptions of quality (Bilkey and Nes, 1982; Liefeld, 1993; Peterson and Joilbert, 1995; Verlegh and Steenkemp, 1999; Papadopoulos and Heslop, 2003). But Klein *et al.* (1998) changed the rules of the game. When the willingness of Chinese consumers to buy Japanese products was

examined, it was found that Chinese consumers are reluctant to buy Japanese brands even though they admitted that Japanese products have higher quality. Their SEM models show that Chinese animosity toward Japanese products is independent of product evaluations as well as consumer ethnocentrism; that is, the belief that buying foreign products is an immoral and inappropriate act (Shimp and Sharma 1987; Shankarmahesh, 2006). In other words, ethnocentric consumers have a tendency to avoid buying products from any foreign country, because they distort or denigrate the quality of foreign products. Meanwhile, consumers having feelings of animosity may find it acceptable to buy products from various foreign countries, but simply refuse to purchase products coming from the target country, even though they assess the product quality correctly (Klein, 2002; Riefler and Diamantopoulos, 2007).

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Customer animosity could be stable, passing from generation to generation and/or situational related to temporary events. In general speaking, war-related animosities are more stable, while non-military ones are more situational (Jung *et al.*, 2002). Although animosity can be classified as war-based vs. economy-based, personal vs. national, situational vs. stable (Klein *et al.*, 1998; Jung *et al.*, 2002; Ang *et al.*, 2004), these are not strictly binary categories. For example, temporary economic animosities arising from perceived unfair and unreliable trade practices and/or the economic power of the foreign country will amplify more stable animosities arising from historical reasons (Riefler and Diamantopoulos, 2007). The impact of consumer animosity also varies depending on the nature of the product and on to what extent customers can make sacrifices. Consumers are more likely to participate in boycotts, if the brand or the product is easy to be substituted and/or non-durable (John and Klein, 2003; Klein *et al.*, 2004). Brands are not unarmed against consumer animosity. They can actively work against consumer animosity by

building reputation and trust among consumers (Jimenez and Martín, 2010), or they can try to deceive consumers by choosing brand names that hide their origin (Mueller *et al.*, 2001) and/or by hoping that consumers are not knowledgeable (Balabanis and Diamantopoulos, 2004; Liefeld, 2004; Samiee *et al.*, 2005).

2.2 Nationalistic Feelings in Financial Markets

Although nationalism is not a new phenomenon for finance practitioners, it is one relatively less researched in finance literature. Even though investors are known to have a home country bias (Sercu and Vanpee, 2007), nationalistic feelings are often dismissed as irrational (Shiller *et al.*, 1996). Nationalism or patriotic feelings could be embedded in home country bias. For example, Finnish investors prefer assets controlled by Finnish managers, since they are more familiar with them (Grinblatt and Keloharju, 2001), but this preference could also be explained by the observation that Finnish people are more patriotic toward Finnish firms (Sercu and Vanpee, 2007). Previous studies found that investors have a natural tendency to be attracted to home markets (Uppal 1992), and that they are more optimistic about their home country stocks and pessimistic about foreign stocks (Solnik and Bascoul, 2007). But these home country biases are generally explained by transaction limitations (Slutz, 1981; Bekaert and Harvey, 2000; Dahlquist *et al.*, 2003), information asymmetries (Brennan and Cao, 1997; Coval and Moskowitz, 1999; Coval and Moskowitz, 2001; Ahearne *et al.*, 2004; Choe *et al.*, 2005) and familiarity bias (Grinblatt and Keloharju, 2001; Huberman, 2001; Chan *et al.*, 2005; Loughran and Schultz, 2005; Bhattacharya and Groznik, 2008).

Beyond home county biases, investors can also express their patriotic feelings in their investment choices. Aside from the special bonds during the times of war, countries with huge diasporas like India and Israel are known to issue special bonds regularly or opportunistically

either to reduce their cost of borrowing or raising capital when access to international capital markets is limited (Ketkar and Ratha, 2010). When we look at the corporate level, companies whose names contain the words “America” or “USA” earned positive abnormal returns during military campaigns which the US was winning, such as World War II, Korean War, and war on terrorism, but not the Vietnam War (Benos and Jochec, 2013). Patriotism is a distinct moderator for home country bias. Even after the controlling general explanations, such as transaction barriers, diversification benefits, information and familiarity, countries scoring high in patriotism on World Values Survey have a much stronger preference for home country assets and avoiding foreign assets (Morse and Shieve, 2011).

In the case of animosity, it could be argued that investors are also affected by deterioration in bilateral relations. These deteriations can be direct, such as corporations with high exposure to Japan and China are more sensitive to China-Japan tensions in Western Pacific (Fisman *et al.*, 2014) or indirect, such as shifts in foreign portfolio investment in the US even after controlling country fixed effects, income, industry growth, financial market development and risk (Gupta and Yu, 2007). Based on the classifications of Jung *et al.* (2002), we can say that those anti-China sentiments in the United Statesare situational animosity that has both personal and national components. China is often accused of engaging in unfair trade practices against the US, criticized for human rights violations, and often comes to odds with the US in the Western Pacific. These sentiments also get another boost due to the COVID-19 pandemic (Silver *et al.*, 2020). The obvious question is, if animosity exists, then why do Chinese companies decide to cross-list in a hostile financial marke?. The answer is similar to the answer to the question why not all non-US companies are not getting listed in the US stock markets despite the well-known benefits such as lower cost of capital and broadened investor base (Doidge *et al.*, 2004). Although Chinese firms

might face animosity, the depth of US financial markets provides significant growth opportunities for Chinese companies.

3. METHODOLOGY

3.1 Data

Data will be gathered from Bloomberg Terminal. There will be three samples. Sample 1 will consist of Chinese companies trading in Dow Jones, S&P 500 and NASDAQ, which have at least $10 million market capitalization. Banking, energy, utility and commodity companies will be excluded. Based on Sample 1, Sample 2 will consist of non-China developing countries' companies with similar market capitalization and the same sub-industry group based on Global Industry Classification. Sample 3 will be consisting of US companies with similar market capitalization and the same sub-industry group based on Global Industry Classification.

3.2 Variables in Ownership Regression

In this regression, it is hypothesized that Sample 1 firms are held less by institutions, such as pension funds, universities, religious organizations, banks and insurance companies due to institutions' exposure to public scrutiny compared to Sample 2 and Sample 3 firms. In ownership regression, similar variables used in Hong and Kacperczyk (2009) will be utilized. A multiple regression with institutional ownership (IO_{it}), the fraction of the shares of company i held by institutions at the end of year t as the dependent variable; $LOGSIZE_{it}$ (natural logarithm of firm i's market capitalization at the end of year t), $LOGMB_{it}$ (natural logarithm of the market-to-book ratio of stock i at the end of year t.), STD_{it} (standard deviation of daily returns during year t), $BETA_{it}$ (beta of firm i in year t), $PRINV_{it}$ (inverse of firm i's share price at the end of year t), and RET_{it} (average monthly return on stock i during year t) as the independent variables will be performed.

3.3 Variables in Analyst Coverage Regression

In this section, it is hypothesized that Sample 1 firms are followed less by analysts who produce financial reports and analyses on companies compared to Sample 2 and Sample 3 firms. In analyst coverage regression, similar variables used in Hong and Kacperczyk (2009) will be utilized. A multiple regression with the $LOGCOV_{it}$ (natural logarithm of one plus the number of analysts covering firm *i* at the end of year *t*) as the dependent variable; $LOGSIZE_{it}$ (natural logarithm of firm i's market capitalization at the end of year t), $LOGMB_{it}$ (natural logarithm of the market-to-book ratio of stock i at the end of year t.), STD_{it} (standard deviation of daily returns during year t), $BETA_{it}$ (beta of firm i in year t), $PRINV_{it}$ (inverse of firm i's share price at the end of year t), and RET_{it} (average monthly return on stock i during year t) as the independent variables will be conducted.

3.4 Variables in Valuation Regressions

In this section, it is hypothesized that Sample 1 firms will be valued less by the market compared to Sample 2 and Sample 3. In valuation regression, the same variables used in Hong and Kacperczyk (2009) will be utilized. A multiple regression with the $LOGMB_{it}$ (natural logarithm of the market-to-book ratio of stock i at the end of year t) as the dependent variable; $LOGPE_{it}$ (natural logarithm of the firm's price-to-earnings ratio at the end of the year t), $LOGPEDITDA_{it}$ (the natural logarithm of the firm's price-to-EBITDA), ROE_{it} (firm i's return on equity in year t), and $RDSALES_{it}$ (fraction of firm i's research and development expenditures to firm sales in year t) as the independent variables will be conducted.

3.5 Variables in Corporate Financing Regressions

In this section, it is hypothesized that Sample 1 firms are having significant leverage differences from Sample 2 and Sample 3 firms. In corporate financing regression, similar variables

used in Hong and Kacperczyk (2009) will be utilized. Two multiple regressions will be conducted. $BLEV_{it}$,(book leverage of firm i in year t, denoted by is total debt divided by the sum of total debt and book equity measured at fiscal year-end) will be used for the first regression and $MLEV_{it}$ (market leverage of firm i in year t, denoted by total debt divided by the sum of total debt and average market capitalization over calendar year t) will be used for the second regression. In both regressions, the same independent variables will be used. Our independent variables are as follows: $CASH_{it}$ is firm i's cash balances divided by book assets at the end of year t. $PAYOUT_{it}$ is calculated as Purchase of Common and Preferred Stock minus preferred stock reduction plus dividends for common stock, all divided by net income for firm i in year t. $DIVPAY_{it}$ is calculated as dividend payouts repurchases minus preferred stock reduction divided by net income for firm i in year t. REP_{it} is repurchases minus preferred stock reduction divided by net income. Tobin's Q, $TOBQ_{it}$ is the market value of equity plus assets minus the book value of equity, all divided by assets, measured at the end of year t. Asset tangibility, $TANG_{it}$, is defined as firm i's net plant, property and equipment divided by total assets at the end of year t and expressed in percentage terms. Profitability, $PROFIT_{it}$, is defined as earnings before interest, taxes and depreciation divided by total assets at the end of year t and expressed in percentage terms. Finally, $LOGSALES_t$ is the natural logarithm of net sales of firm i in year t.

5. DISCUSSION

In the marketing literature, consumer animosity is defined as consumers' hostility toward a specific country's products. Unlike consumer ethnocentrism, where consumers favor domestic products and have negative quality perceptions toward foreign products, in consumer animosity, consumers are hostile toward products from a particular country even though they have clear information about product quality and have little or no problem with using foreign-based products.

In the finance literature, it is well-recorded that sin stocks are treated differently by the market despite their successful performances. By integrating sin stock studies from finance and consumer animosity studies from the field of marketing, this paper argues that ongoing tensions between the United States and China lead to significant negative effects on Chinese stocks traded in major US stock exchange markets.

Based on Hong and Kacperczyk (2009); institutional ownership, analyst coverage, firm valuation and corporate financing of the Chinese firms traded in major US stock markets between 2010 and 2020 are analyzed. To separate home country bias from consumer animosity, three samples will be created. It is hypothesized that Chinese firms are held less by institutions, covered less by analysts, valued less by the market, and have different leverage than other developing countries' companies.

6. MANAGERIAL & THEORETICAL IMPLICATIONS

This interdisciplinary paper has both theoretical and managerial implications that are hoped to benefit both marketing and finance scholars and practitioners. From the marketing perspective, consumer animosity is mostly tested in the context of durable products, especially consumer electronics. This study is the first one analyzing a financial product. From the finance perspective, this paper aims to enrich cross-listing literature by adding a new national variable that was previously not used in finance. Although the usage of nation-level variables is pretty common in cross-listing studies, those variables are often corporate governance-related, such as rule of law or the protection of investors' rights. Our study is the first one that analyzes animosity in the finance literature.

From the managerial perspective, it is hoped that this study will provide insights for both top management teams and investors. Top management teams should take historical and

contemporary relationships between the home country and host country into account when it comes to cross-listing. Although cross-listing may provide personal benefits to top management teams, such as having more prestigious and higher compensations, and to investors, such as better growth opportunities, lower agency costs, lower cost of capital and lower transaction cost (Doidge *et al.*, 2004), these benefits may be reduced or eradicated due to animosity.

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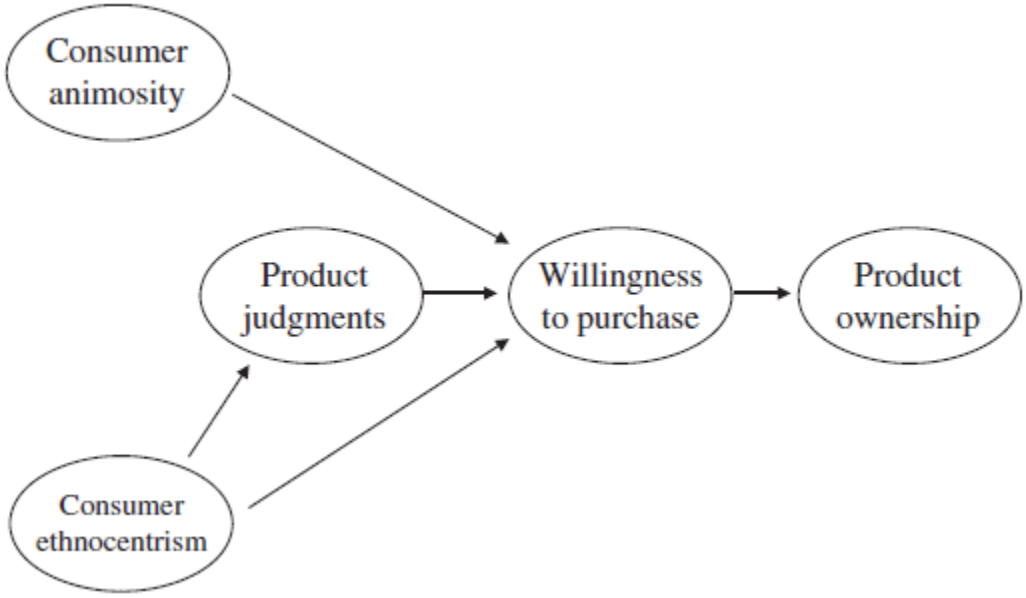
TABLES AND FIGURES

FIGURE 1



Animosity model of foreign product purchase (Klein *et al.*,1998)