The Speed of Communication

Abstract

We study the speed of effective communication among investors, by examining the trading behavior of target-firm shareholders and their neighbors in mergers and acquisitions, whereby the acquirer firm comes from a different industry. We conjecture that once endowed with shares of the acquiring firm, target investors start gathering information about the acquirer industry (“patient zero”). Further, target investors communicate their newly acquired views with other investors in their neighborhood via word-of-mouth. Empirically, we find that in the year after acquisition completion, both target investors and their neighbors significantly increase their trading activity in the acquirer industry (excluding the acquirer firm itself). Drawing from research on disease transmission, we estimate an information transmission matrix to quantify the effective communication rate across investors and how it varies with (dis)similarities in social characteristics. Our results imply that a ten-year difference in age, a one-step difference in income and a ten-percent difference in male-female ratio reduces the communication rate by 33%, 28%, and 9%, respectively.