Rumor Mill or Crowd Wisdom? The Effects of Social Media in the Presence of False Rumors

Abstract

We study whether social media activities distort the price discovery of potentially false information. We focus on merger rumors, where most do not materialize. We find that rumors accompanied by greater Twitter activities are less likely to be accurate while eliciting greater market reaction. Among falsely rumored targets, rumor-period tweet volume appears to distort the immediate market reaction and prolong the price discovery. Such behavior is more pronounced among targets with low institutional ownership and rumors that supply more details. Our evidence suggests that social media can be a rumor mill that hinders the market’s discovery of potentially false information.