Do financial analysts care about extra-financial information?

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1. Motivation
2. Econometric Model
3. Methodology
   - Variables
   - Statistical Techniques
   - Available Results

SRI and social dimensions

- Increasing awareness regarding firms externalities
- A trend of internalisation (anticipation of regulatory changes, reputation opportunities or risks, etc.)

Existing literature

- Evidence for increased financial performance (Derwall et al. 2005)
- Evidence for SRI-related costs (Getzy et al. 2005)
- The non-incorporation of intangibles—such as employee satisfaction—into stock prices (Edmans 2009)

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- Are the social ratings reflected in financial forecasts?
- To what extent does extra-financial information impact the market perceptions?

Two processes

- $C_t^i = F_t^i + P_t^i + \varepsilon_t^{C^i}$
- $R_t^i = P_t^i + E_t^i + \varepsilon_t^{R^i}$

Details

- Assumptions
  - independent random variables
  - exogenous processes
- Hypothesis
  - $cov\left(C_t^i, R_t^i\right) = var\left(P_t^i\right) > 0$
- Issues
  - Asynchronous observation times
  - Comparability of C_t across stocks

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Financial forecasts

- A proxy for the market consensus
- Short-term: IBES one- and two-year ahead earnings per share (EPS) estimates
- Long-term: S&P credit ratings

Extra-financial ratings

- Relative measures of major qualitative issue areas
- KLD social dimensions: community, governance, diversity, employee relations, environment, human rights and product

Control variables

- Independent, firm- and market-specific variables: industry, market value, bid-ask spread, intangibles, return on assets, book to market ratio, capital expenditure, leverage, etc.

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- Binary response models
  - probit regression
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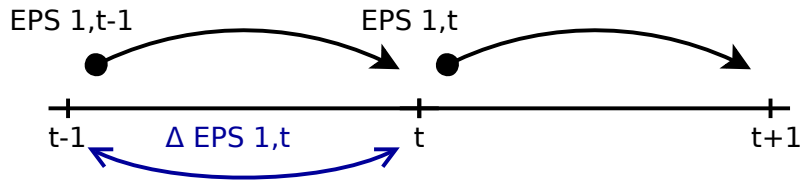
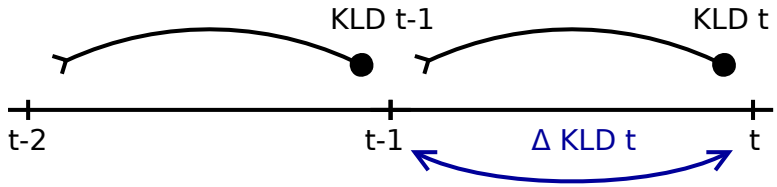
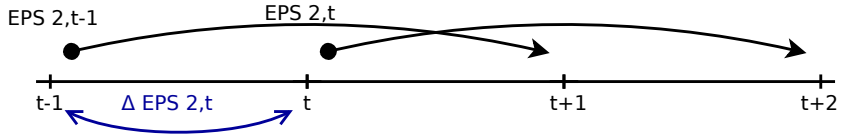
Yearly evolutions (absolute values or percentages)

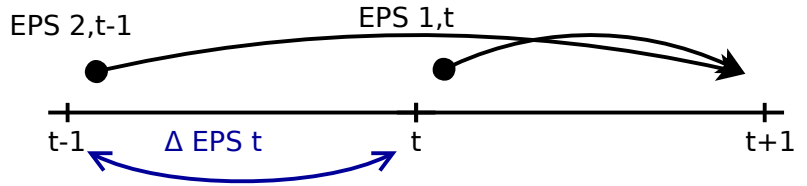
Formulae

1. $\Delta EPS_{1,t} = \frac{EPS_{1,t} - EPS_{1,t-1}}{EPS_{1,t-1}}$
2. $\Delta KLD_t = \frac{KLD_t - KLD_{t-1}}{KLD_{t-1}}$
3. $\Delta EPS_{2,t} = \frac{EPS_{2,t} - EPS_{2,t-1}}{EPS_{2,t-1}}$
4. $\Delta EPS_t = \frac{EPS_{1,t} - EPS_{2,t-1}}{EPS_{2,t-1}}$









Available Results

- Mean historical EPS forecasts
- 1993–2007
- ∼3,250 firms and ∼10,000 data points
- Non-parametric correlation tests (Spearman and Kendall)

- All coefficients $<10\%$ in magnitude
- Four coefficients—beginning with the year 2002—significant at a 10% level

- Robustness checks on median EPS forecasts

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Concluding remarks

- Some association exists between social ratings and financial forecasts

Questions? Feedback?

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