Every Little Helps?

ESG news disclosure and stock market reaction

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CSR, SRI, ESG, 3BL, PPP, NJFP…

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Previous studies (1/2)

- **Harmful environmental news**
  - The Toxic Release Inventory program in the US (Hamilton, 1995)
  - Other public disclosure program in developed countries
  - Judicial actions following environmental violations (Karpoff, Lott & Wehrly, 2005)
  - A broad set of environmental events (Klassen & McLaughlin, 1996)
- **Industrial accidents with environmental concerns**
  Capelle-Blancard & Laguna (2010)

Previous studies (2/2)

- **Other extra-financial events**
  - Product recalls (Jarrell & Peltzman, 1985)
  - Airline crashes (Borenstein & Zimmerman, 1988)
  - Product tampering (Mitchell, 1989)
  - Corporate fraud (Karpo and Lott, 1993)
  - Unethical behavior (Gunthorpe, 1997)
  - Massive layoffs (Farber & Hallock, 2009; Capelle-Blancard & Tatu, 2012)

What's new?

- A common limit of the previous papers is that they focus on **extreme events**.
- Oil spills, accidents, toxic release, product tampering, corporate fraud, etc. have a significant negative impact.
- But what about less dramatic everyday events? How shareholders react to **very ordinary events**?
- These questions are important since CSR does not consist merely in avoiding ecological disasters. Instead, according to its proponents, CSR should be embedded in all corporate operations.

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What do we do?

- We propose a set of theoretical hypothesis to explain the impact of ESG news on firm's market value
- We build an original sample : > 75,000 events concerning 100 firms over 2002-2010.
- We assess the drivers of the stock market response to ESG news

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The impact of ESG news on firm value

Outline

- Theoretical Foundations and Hypotheses
- Data on ESG news
- An empirical assessment
  - Event study
  - How to explain abnormal returns?

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ESG news are newsworthy…

- *"It is virtually impossible to open the business section of the New York Times, the Wall Street Journal, The Economist, or any business publication today without seeing mention of measures being taken by some company to become more socially responsible."*

Paul R. Portney (2008)

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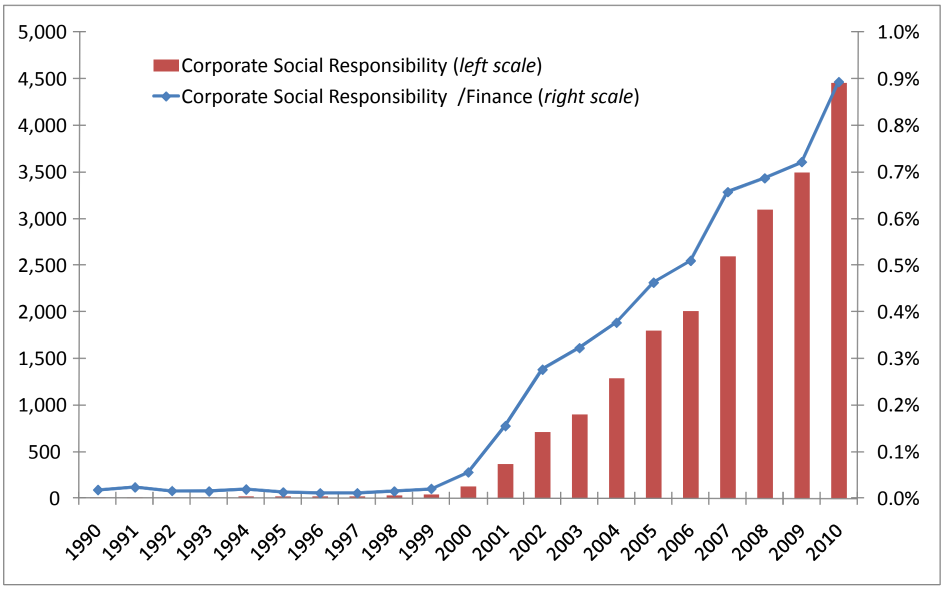

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- ESG news are simply increasingly popular
- Information on CSR is likely to make good stories
- Soft news on ESG issues, and the emotive language associated, are more appealing for a large audience than hard information… but they are more difficult to process

… but are they market movers?

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H1 : ESG news have a significant effect on firms' market value

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The carrot or the stick?

- The (a)symmetry of the impact of ESG news.
- Historically, investor awareness on ESG issues resulted in the rejection of the so-called *"sin stocks"*.
- Practices have evolved and nowadays socially responsible investors used generally both negative and positive screens.

- ***H2 : Negative ESG news impact more firms' market value than positive ESG news.***

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PR versus CSR

- ***H3 : ESG news from external sources impact more firms' market value than ESG news from the firms themselves.***

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CSR: fashionable?

- ***H4 : The impact of ESG news is stronger and stronger***

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When bad CSR happens to good companies

- The theoretical literature concerning the effect of the firms' reputation on their performance is unconclusive.
- A reservoir of goodwill in times of crisis?
- Boomerang effect in case of disappointment?

- ***H5a : The impact of negative ESG news is lower for a firm with a good ESG reputation.***
- ***H5b : The impact of negative ESG news is lower when the firm belong to a sector which enjoy a good ESG reputation.***

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Out of sight, out of mind?

- Engelberg & Parsons (2011) show also that the impact of media on nancial markets is influenced by the distance, for earning announcements in the US.

- ***H6 : The impact of ESG news on firms' market value is higher when the event is local (the event involves the community).***

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Content analysis

- Content analysis is a research technique for the objective, systematic and quantitative description of the manifest content of communication

- ***H7a: The impact of ESG news on firms' market value is higher when the article contains words with an active, economic, legal or quantitative orientation.***
- ***H7b: The impact of ESG news on firms' market value is lower when the article contains words with an abstract or qualitative orientation.***

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Driven to distraction

- An increased attention on a given company could increase the impact of an event on the stock markets.
- We use data from Google insights for search as proxy variable for emphasized attention.

- ***H8: The impact of negative ESG news is higher when the firm is subject to a higher attention.***

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Covalence

- Created in 2001 in Geneva, Covalence has developed, in partnership with Datadoxa, a systematic collection of positive and negative ESG information concerning the world's largest companies.
  - Positive news include announcement of a social sponsoring program, the launch of new eco-innovative product, a green award, etc.
  - Negative news relate to toxic release disclosure, rumors of downsizing, and the divulgation of bad labor practices in subcontractor factories, etc.
- Each day 20 analysts perform a total of 80h of reading, screening 2,000 news items. As of 2010, their database includes more than 190,000 information items from more than 10,000 sources, covering more than 500 firms.

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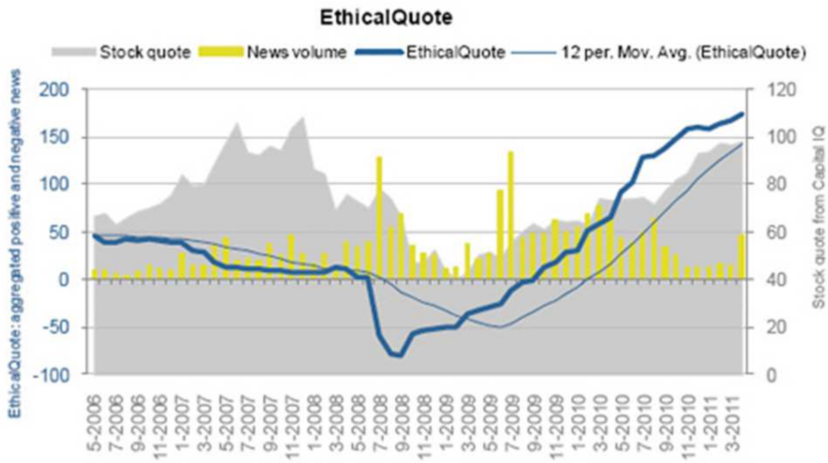
Table 1: **Some examples of ESG news (excerpts)**

This table reports some examples of ESG news extracted from the Covalence database.

Bayer 01/03/2002 E(−), Media	"Bayer was one of several multinationals to export highly toxic obsolete pesticides to Nepal, and abandon them there after they reached their expiry date or were banned. (...) The obsolete pesticides had been inadequately stored in rusting and rotting original packaging (...). The toxic waste threatens the health of residents, workers and livestock in the area as well as local water supplies, irrigation systems and soil. Despite requests to Bayer from the Royal Nepalese Government, the company has refused to help."
Coca-Cola 08/12/2002 E(−), Media	"A Coca-Cola bottling plant in Kerala (India) gets its water from 60 wells the plant has drilled in the area. Local villagers claim this is draining their water supply and leaving what is left contaminated. (...) Protesting villagers want the plant closed but Coke says (...) they 'have not found any change in the water situation'."
Procter & Gamble 12/20/2004 S(+), NGO	"A new water purification product developed by Procter & Gamble is being launched in Haiti, where diarrhea is a major killer of children under 5, by an initiative funded by the Global Development Alliance of the U.S. Agency for International Development (USAID)."
Wal-Mart 11/14/2003 S(−), Media	"Wal-Mart, the world's biggest company and the largest employer in the US, is being taken to court by a group of former immigrant employees. The workers have accused the US supermarket chain of conspiring with cleaning contractors to employ them in conditions that were "one step away from slavery" (...) foreign workers have told of working seven-night, 56-hour weeks at the budget stores for as little $325, well below the national minimum hourly wage."
Riggs Bank 01/27/2005 G(−), NGO	"Riggs Bank pleaded guilty to helping former Chilean dictator Augusto Pinochet and the leaders of oil-rich Equatorial Guinea hide hundreds of millions of dollars. The federal judge questioned whether a $16 million fine agreed to by prosecutors was enough. U.S. District Judge Ricardo Urbina in Washington today asked whether the penalty is "just a business expense" that wouldn't even cover the profits Riggs made on the suspect accounts. (...)"

Covalence
EthicalQuote.com



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Data

- 75,218 ESG events, positive or negative from January 2002 to December 2010 concerning 100 multinational publicly listed firms.
- Company name
- Event date, Countries of occurrence
- Source of disclosure:
  - media (including internet) and social authorities (governmental bodies, academics, international organizations)
  - NGOs and trade unions
  - The companies themselves
- 45 ESG criteria classication

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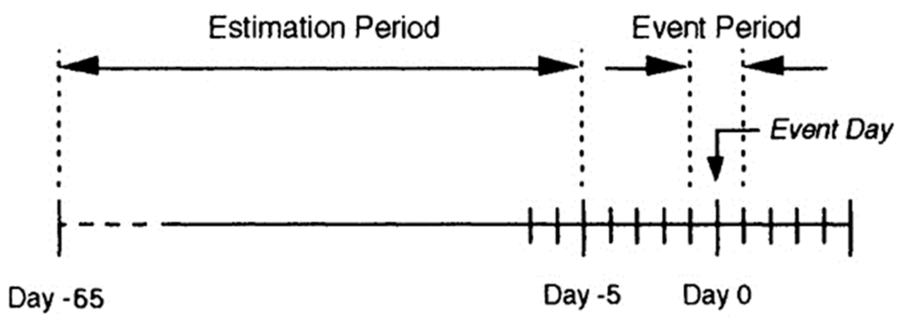
Number of events by source and criterion

Table 1: **Number of ESG news by category**

This table documents the number of negative and positive ESG news included in the sample, breakdown by source (the firms, the medias, the NGOs) and topic (environment, social and governance). One hundred firms are considered (see the list in Appendix) over the period 2002-2010. Given that some news have been published by several sources and/or are related to several ESG issues, the total number of news is lower than the sum of the categories.

	All		**Firm**		**Media**		**NGO**	
	Positive	Negative	Positive	Negative	Positive	Negative	Positive	Negative
Environment	8,079	2,283	810	30	6,976	1,780	341	474
Social	9,311	5,106	1,328	85	7,457	4,301	551	735
Governance	7,625	4,978	915	69	6,420	4,043	319	887
Total	21,233	10,304	2,577	159	17,729	8,547	1,026	1,632

Event study methodology



The impact of ESG news on financial performance – overall results

Table 2: **ESG events impact on financial performance**

This table presents the average change in market value following ESG news. AAR_0 is the average abnormal returns the day of the announcement and $CAAR_{[-1;+1]}$ is the cumulative average abnormal returns over the three days around the announcement date. The estimation period is [-65,-5].

	All		Firm		Media		NGO	
	Positive	Negative	Positive	Negative	Positive	Negative	Positive	Negative
AAR_0	−.003	−.025	.002	−.194	−.002	−.031*	−.020	.025
(s.d.)	(.011)	(.017)	(.028)	(.185)	(.012)	(.019)	(.045)	(.037)
$CAAR_{[-1;+1]}$	.002	−.100*	−.087	−.088	.012	−.137**	.057	.100
(s.d.)	(.036)	(.055)	(.097)	(.497)	(.040)	(.062)	(.145)	(.111)
Obs.	21,233	10,304	2,577	159	17,729	8,547	1,026	1,632

*,**,*** indicate statistical significance at the 10%, 5%, 1% level respectively.

Table 3: **Impact of negative events disclosed by the media**

Concern								
Environment	-.253	-.313	-.189	-.097				
	(.276)	(.225)	(.231)	(.188)				
Social	.060	-.192	.134	.172				
	(.261)	(.220)	(.213)	(.186)				
Governance	.246	.038	.267	.273				
	(.244)	(.198)	(.202)	(.173)				
Sector high importance	.049	.183	-.015	.044				
	(.206)	(.174)	(.161)	(.140)				
Source								
Finance	-.166	-.132	-.085	-.137				
	(.233)	(.196)	(.216)	(.179)				
CSR	.385	.344	.215	.314	.235	.254	.138	.222
	(.240)	(.195)*	(.222)	(.182)*	(.189)	(.160)	(.157)	(.140)
Trend								
Time (month)	-.005	-.005	-.003	-.003	-.009	-.007	-.005	-.002
	(.004)	(.003)*	(.003)	(.003)	(.003)***	(.003)**	(.003)*	(.002)
Economic crisis	-.012	-.001	-.001	.008				
	(.011)	(.009)	(.009)	(.007)				
Content analysis								
Economic	-.166	-.033			-.155	-.036		
	(.100)*	(.089)			(.098)	(.087)		
Legal	-.087	-.096						
	(.203)	(.183)						
Qualitative	.672	.554			.772	.623		
	(.335)**	(.262)**			(.334)**	(.263)**		
Quantitative	-.567	-.507			-.583	-.520		
	(.230)**	(.175)***			(.230)**	(.174)***		
Reputation	1.123	1.007	1.366	1.001	1.401	1.003	1.353	.881
	(.613)*	(.521)*	(.516)***	(.470)**	(.560)**	(.472)**	(.473)***	(.434)**
Greenwashing	.127	.383	.186	.350				
	(.711)	(.585)	(.580)	(.502)				
Geography								
Distance (log)	.035		-.098					
	(.096)		(.068)					
Common language	-.601		-.352		-.335		-.276	
	(.240)**		(.186)*		(.222)		(.179)	

Conclusion

- Investors and analysts have access to more Environmental, Social and Governance (ESG) information than ever before.
- And whether they like it or not, firms have to take into account the social responsibility of their actions.

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Conclusion

- This paper examines the stock markets reactions to ESG events included in the Covalence-EthicalQuote database (75,218 occurrences concerning 100 listed companies on the period 2002-2010).
- The stock market reacts negatively and instantaneously to negative ESG information but not to positive ones.
- The only source of reliable information is the medias.
- The better the reputation, particularly for companies inside their sector, the lower the losses.
- Cultural proximity and quantitative tone are other sources of additional losses

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