

On the Effect of Social Environment of Racial Inequality: Trump Election and Minority CEO Pessimism

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How does a change in social environment of racial equality affect minority CEO pessimism?

Motivation

- *Many, if not most, of the conflicts we observe today are ethnic in nature* (Esteban and Ray, 2008; Brubaker and Laitin, 1998)
- Racial inequality pervades every aspect of society
 - ▶ Employment; racial wage gap; loan application (Betrand and Duflo, 2016)
- Recent research on socioeconomic consequence of racial inequality
 - ▶ Social capital, government quality and contemporary regional development (Kyriacou, 2013; Tesei, 2014; Alesina et al., 2016)
- **Limited evidence on how racial inequality plays a role in individual preference and judgement**

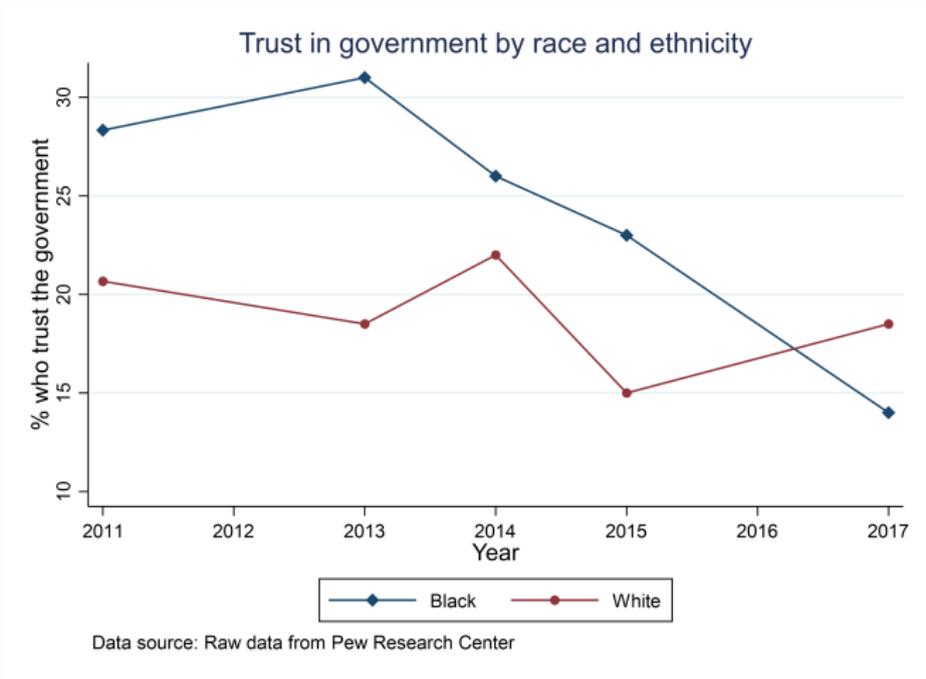
Motivation

- This paper focuses on minority CEOs' judgement of firm fundamentals
 - ▶ Elites contribute financial resources to ethnic conflict (Esteban and Ray, 2008)
- Rationale
 - ▶ Racial inequality → mood disorder → biased personal judgement
- Identification challenge
 - ▶ personal judgement is endogenous to individual ethnicity
- **This paper explores Trump Election as a negative exogenous shock to the racial environment**

Trump Election as an Exogenous Shock

- Unexpected: in the morning of Election Day, Trump's probability of winning was 17% on Betfair
- Salience of ethnic conflicts
 - ▶ What does Trump SAY and DO?
 - ★ Racist tweets claiming that four Democratic women of color in Congress should "go back..."
 - ★ Travel ban and refugee suspension
 - ▶ What are the views from the public or ethnic minorities?
 - ★ General public: more common to express racist views after the election
 - ★ Ethnic minorities: 75% of Asians, blacks and Muslims mention unfairly treatment due to ethnicity

Trust in the Government



Preview of Findings

Key Takeaway: The paper provides the first causal evidence that Trump Election induces behavioural bias in the form of pessimism in minority CEOs

- Minority CEOs exhibit more pessimism in earnings forecasts (*underestimation of the mean of earnings*) following Trump Election, compared with their non-minority counterparts
- Textual analysis of risk factor suggests that minority CEOs are more concerned about risk (*overestimation of risk*)
 - ▶ More concerned about litigation risk and migration risk
- Minority CEO pessimism is partially driven by psychological bias
 - ▶ The effect is stronger for firms with less experienced and less confident minority CEOs

- Literature on racial inequality
 - ▶ Existence of racial inequality (Becker, 1957; Phelps, 1972; Arrow, 1973; Bertrand and Mullainathan 2004)
 - ▶ Economic consequence: social capital, government quality and contemporary regional development (Kyriacou, 2013; Tesei, 2014; Alesina et al., 2016)
- Literature on managerial sentiment
 - ▶ Relatively new area in contrast to investor sentiment (Jiang, Lee, Martin, and Zhou, 2019)
 - ▶ Economic consequence on asset pricing, accrual estimates, credit origination, CEO compensation (Hribar et al., 2017; Chen et al., 2018; Jiang et al., 2019)
- **This paper: the first micro-level causal evidence linking racial inequality and personal judgement**

Data and Specification

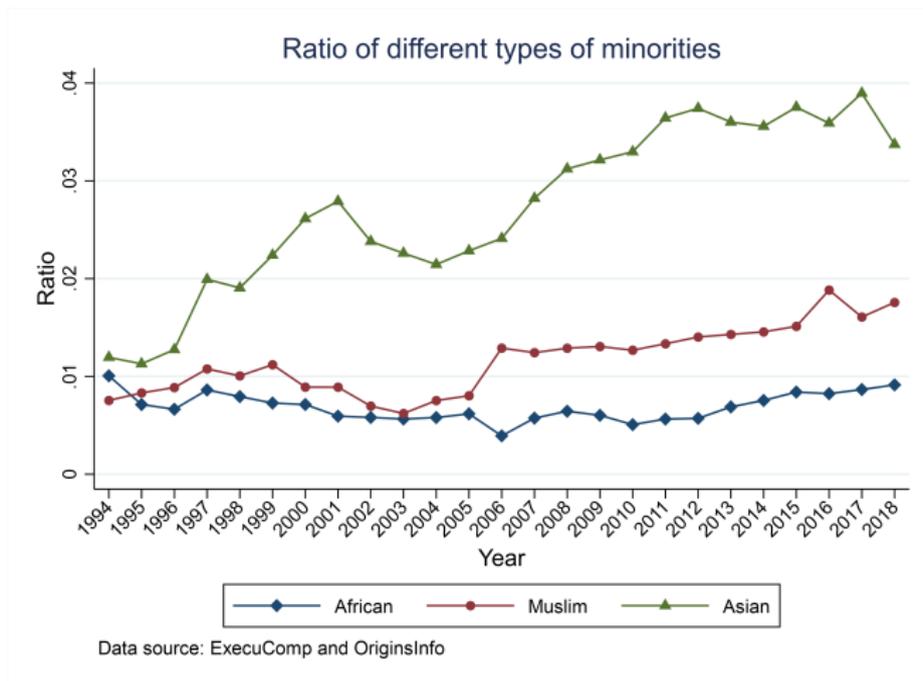
Firm-quarter Difference-in-Differences:

$$\begin{aligned} Pessimism = & \beta_1 MinorityCEO \times TrumpPost + \beta_2 MinorityCEO + \beta_3 TrumpPost \\ & + \beta_4 LogHorizon + \theta CEOCharacteristics + \pi FirmCharacteristics \\ & + IndustryFE + \varepsilon \end{aligned}$$

- Pessimism: MgtSentimt and BiasScale
- MgtSentimt=(number of pessimistic forecasts-number of optimistic forecasts)/total number of forecasts in a quarter
- BiasScale=(forecasted EPS-actual EPS)/assets per share
- CEO Characteristics: age, salary, gender and indicator variable of whether a CEO serves on the board
- Firm characteristics: firm size; leverage; MB; profitability; return volatility; earnings volatility; institutional holdings; analyst following
- Sample period: 2014Q3-2018Q4; 10400 firm-quarters

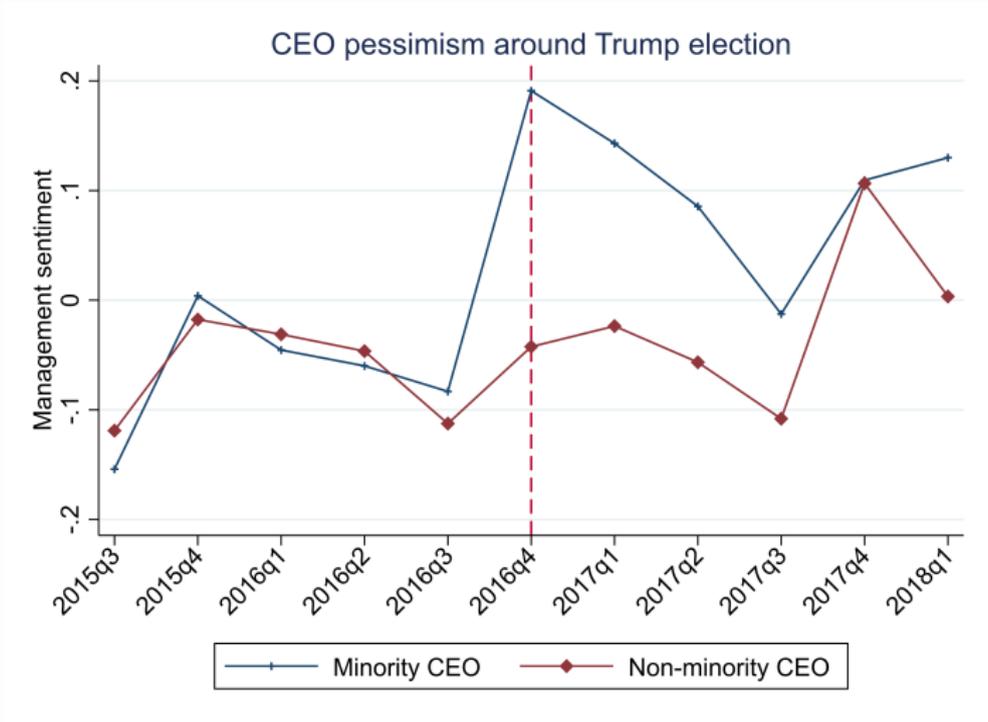
Measuring CEO Ethnicity

- Minority CEO: a given CEO is a black, an Asian (including Hindu and South Asian, Sikh and East Asian) or a Muslim (coming from Middle East or North Africa)



Minority CEO Pessimism

DiD figure



Minority CEO Pessimism-Baseline Results

- Management sentiment: (number of pessimistic forecasts-number of optimistic forecasts)/total number of forecasts in a quarter
- Bias scale: (forecasted EPS-actual EPS)/assets per share

VARIABLES	(1)	(2)	(3)	(4)
	Management sentiment		Bias scale	
	MgtSentimt	MgtSentimt	BiasScale	BiasScale
MinorityCEO	-0.028*	0.052	0.003	-0.062
	(0.014)	(0.037)	(0.026)	(0.036)
MinorityCEO×TrumpPost	0.117***	0.098***	-0.063***	-0.049*
	(0.015)	(0.023)	(0.016)	(0.023)
LogHorizon	Yes	Yes	Yes	Yes
CEO Controls	Yes	Yes	Yes	Yes
Firm Controls	Yes	Yes	Yes	Yes
Industry×Quarter FE	Yes	No	Yes	No
Firm FE	No	Yes	No	Yes
Quarter FE	No	Yes	No	Yes
Observations	10400	10400	10400	10400
Adj R-sq	0.142	0.231	0.0631	0.271

Overestimation of Risk

Textual analysis of risk factor section in 10-K

Loughran and McDonald (2018) financial dictionary Baker, Bloom and Davis (2016) and Campbell, Cecchini, Cianci, Ehinger, and Werner (2019)

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	TonePessim	TotWords	RiskWords	MigrRisk	IdioRisk	LitigRisk	PolRisk
MinorityCEO×TrumpPost	0.003*** (0.001)	0.382*** (0.091)	0.202*** (0.053)	0.096*** (0.017)	0.283*** (0.082)	0.281*** (0.081)	0.085*** (0.020)
CEO Controls	Yes						
Firm Controls	Yes						
Firm FE	Yes						
Year FE	Yes						
Observations	3326	3326	3326	3326	3326	3326	3326
Adj R-sq	0.463	0.400	0.508	0.619	0.461	0.473	0.501

Behavioral Explanation

Less experienced and less confident minority CEOs are more affected

Panel A: Inexperienced and less confident minority CEOs

VARIABLES	(1)	(2)	(3)	(4)
	Experienced and more confident		Inexperienced and less confident	
	MgtSentimt	BiasScale	MgtSentimt	BiasScale
MinorityCEO	0.836 (1.835)	-0.526 (0.883)	0.000 (0.057)	-0.088 (0.102)
MinorityCEO×TrumpPost	-0.356 (0.728)	0.209 (0.371)	0.222*** (0.053)	-0.128*** (0.031)
LogHorizon	Yes	Yes	Yes	Yes
CEO Controls	Yes	Yes	Yes	Yes
Firm Controls	Yes	Yes	Yes	Yes
Industry×Quarter FE	Yes	Yes	Yes	Yes
Observations	154	154	3,147	3,147
Adj R-sq	0.263	0.144	0.121	0.0376
<i>P-value of LR test</i>	(3)-(1): 0.06		(4)-(2): 0.03	

- Consistent with behavioral story

Ruling out Alternative Explanations

<i>Panel A: Democratic CEO</i>			<i>Panel B: Minority CEO turnover</i>	
VARIABLES	(1) MgtSentimt	(2) BiasScale	VARIABLES	(1) CEOTurnover
DemCEO×TrumpPost	-0.038 (0.023)	0.007 (0.020)	MinorityCEO	0.005 (0.012)
LogHorizon	Yes	Yes	MinorityCEO×TrumpPost	-0.014 (0.020)
CEO Controls	Yes	Yes	CEO Controls	Yes
Firm Controls	Yes	Yes	Firm Controls	Yes
Firm FE	Yes	Yes	Industry×Year FE	Yes
Quarter FE	Yes	Yes	Observations	13852
Observations	6103	6103	Adj R-sq	0.0301
Adj R-sq	0.095	0.259		

<i>Panel C: Market reaction</i>					
VARIABLES	(1) RawRet	(2) AR	(3) CAR1Day	(4) CAR3Day	(5) CAR7Day
MinorityCEO	-0.003 -0.002	0.001 -0.003	-0.462 -2.122	-0.56 -4.216	1.746 -5.674
Firm Controls	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Observations	686	686	686	686	686
Adj R-sq	0.28	0.202	0.0628	0.0547	0.0481

- Not driven by difference in political ideology, CEO career concern or expected change in firm fundamentals

Takeaway

- The paper finds that Trump Election induces behavioural bias in the form of pessimism in minority CEOs
- It makes contribution to racial inequality literature, as well as managerial sentiment literature, in that it provides the first causal evidence on how racial inequality affects individual judgement