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Does Media Coverage of Firm's Environment, Social, and Governance (ESG) Incidents Affect Analyst Coverage and Forecasts?

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Abstract

Media coverage of environment, social, and governance (ESG) issues provides useful information for analysts as corporate social irresponsibility events potentially influence corporate performance and risks. Our study explores whether and how analysts respond to media coverage of corporate social irresponsibility by examining its relationship with analyst coverage and forecasts. We find evidence that the level of analyst coverage is negatively associated with a firm's ESG incidents covered by the media. This association is more pronounced for firms with high business risk, high information risk, more intense industrial product market competition, and more severe ESG scandals. We also find a positive association between media-covered ESG incidents and analyst forecast error and dispersion, suggesting that analysts might fail to incorporate the ESG risk exposures into their forecasts in an appropriate manner. The business risk and information risk tend to be higher for firms that are covered by the media for having got involved in ESG incidents, thereby explaining why the analyst coverage and forecasts for these firms are adversely affected. Overall, our results suggest that corporate social irresponsibility undermines the role analysts play as information intermediaries for investors in the stock market.

Idea Framework (Supply curve)

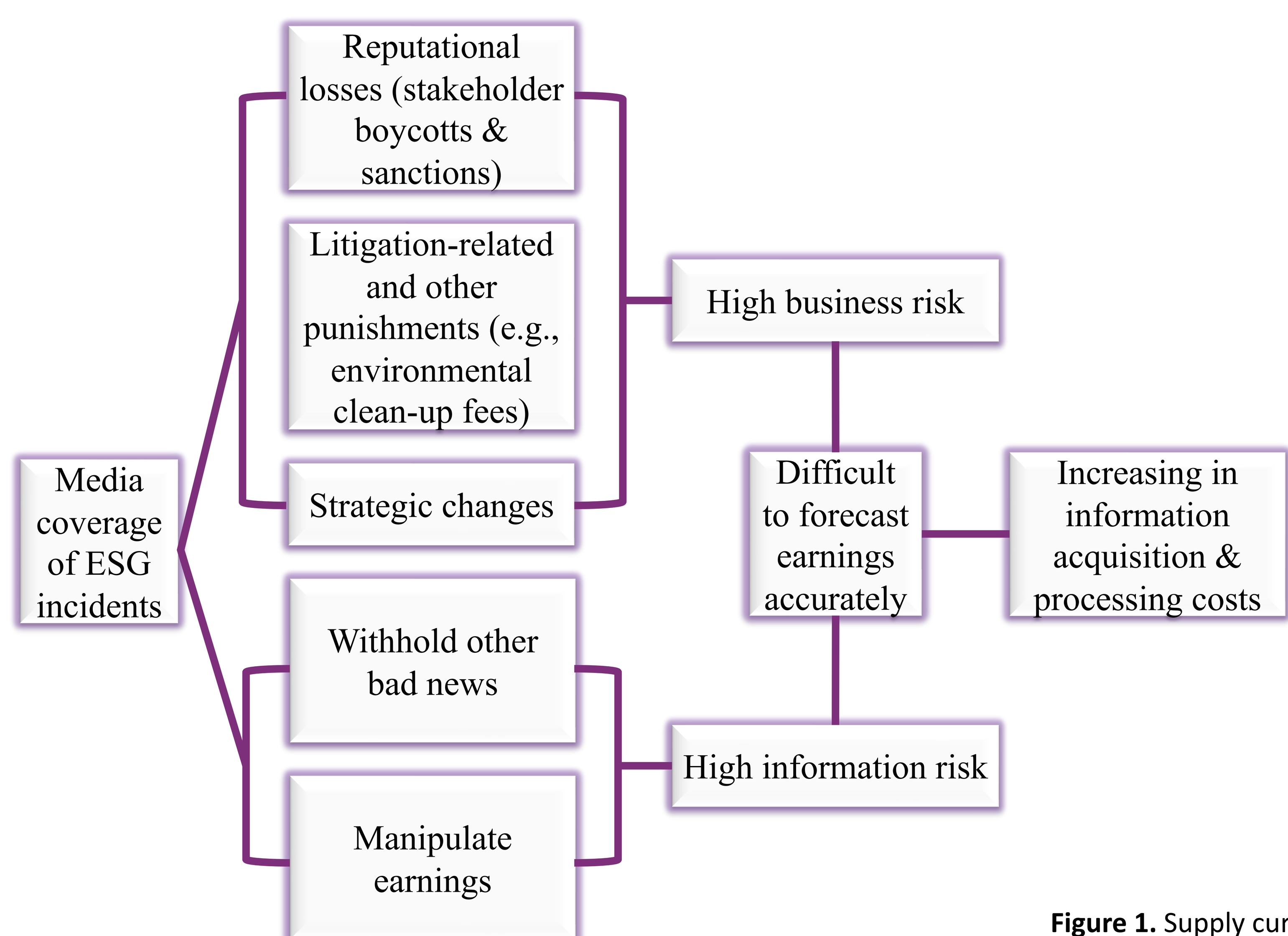

Figure 1. Supply curve

Idea Framework (Demand curve)

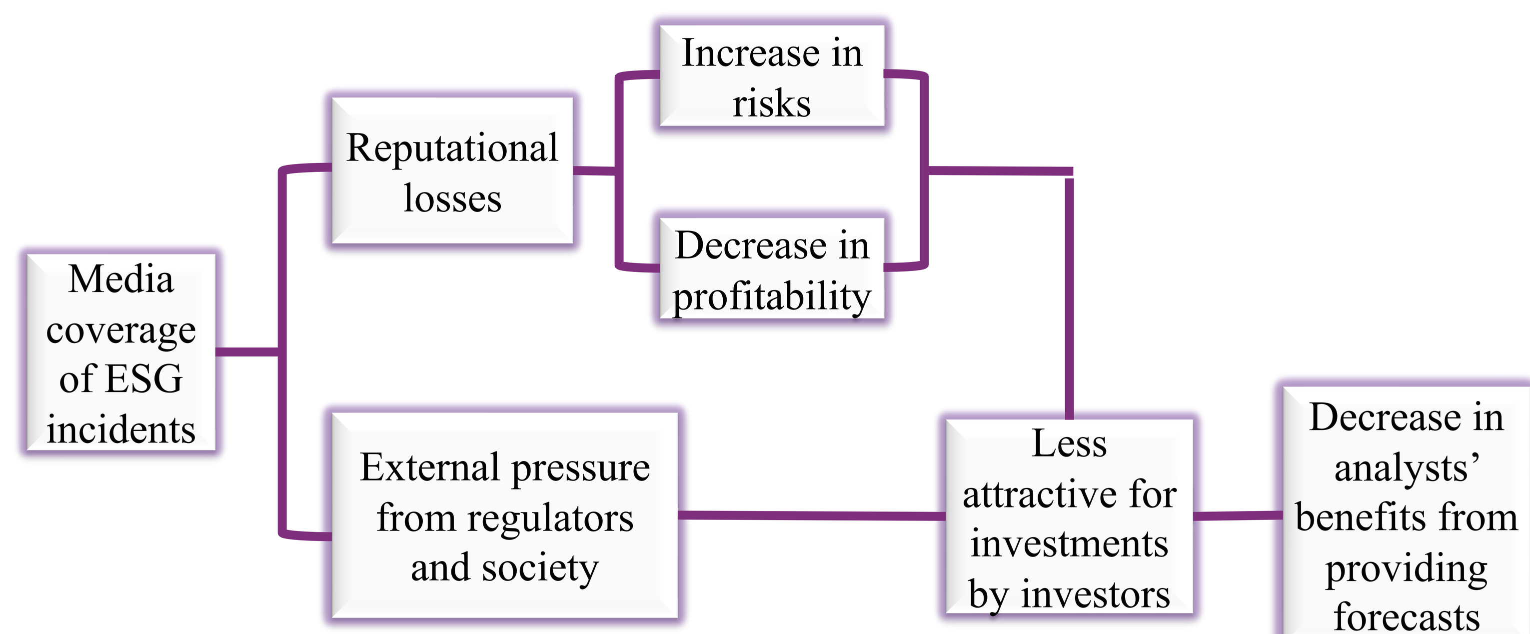

Figure 2. Demand curve

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Motivations

We focus on media coverage of the negative ESG incidents to explore the market consequences of CSI for three reasons:

- It is less likely for a firm to self-disclose its ESG incidents, as managers tend to withhold bad news. The economic consequences of CSI to a firm depend crucially on how well the CSI is known to widespread stakeholders. The media can serve this end well by revealing and disseminating CSI-related information to a wide variety of stakeholders.
- The media has a high motive to report ESG incidents to cater to the stakeholders' and public's information needs.
- A firm might engage in CSI and CSR simultaneously. CSI concerns market participants more than CSR. Meanwhile, it often takes years for a firm to establish good reputation via CSR activities, while corporate reputation could be ruined by ESG scandals in seconds once discovered by the public. Media coverage of ESG incidents is a relatively clean measure of CSI and thus the focus of our study.

Research design

$$\text{lnanacov}_{t+1} = \alpha_0 + \alpha_1\,\text{avg_rri_std}_t + \alpha_2\,\text{size}_t + \alpha_3\,\text{idiosynretvol}_t + \alpha_4\,\text{price}_t + \alpha_5\,\text{qtrret}_t + \alpha_6\,\text{roa}_t + \alpha_7\,\text{finconstraint}_t + \alpha_8\,\text{r\&d}_t + \alpha_9\,\text{intangible}_t + \alpha_{10}\,\text{btm}_t + \alpha_{11}\,\text{insti}_t + \alpha_{12}\,\text{tradingvol}_t + \alpha_{13}\,\text{regulated}_t + \alpha_{14}\,\text{year_dummy} + \alpha_{15}\,\text{industry_dummy} + \varepsilon$$

$$\text{error}_{t+1} = \alpha_0 + \alpha_1\,\text{avg_rri_std}_t + \alpha_2\,\text{size}_t + \alpha_3\,\text{price}_t + \alpha_4\,\text{qtrret}_t + \alpha_5\,\text{idiosynretvol}_t + \alpha_6\,\text{intangible}_t + \alpha_7\,\text{tradingvol}_t + \alpha_8\,\text{insti}_t + \alpha_9\,\text{btm}_t + \alpha_{10}\,\text{roa}_t + \alpha_{11}\,\text{finconstraint}_t + \alpha_{12}\,\text{horizon}_t + \alpha_{13}\,\text{change_roa}_t + \alpha_{14}\,\text{change_eps}_t + \alpha_{15}\,\text{surprise}_t + \alpha_{16}\,\text{gexp_average}_t + \alpha_{17}\,\text{bsize_average}_t + \alpha_{18}\,\text{year_dummy} + \alpha_{19}\,\text{industry_dummy} + \varepsilon$$

$$\text{dispersion}_{t+1} = \alpha_0 + \alpha_1\,\text{avg_rri_std}_t + \alpha_2\,\text{size}_t + \alpha_3\,\text{price}_t + \alpha_4\,\text{qtrret}_t + \alpha_5\,\text{idiosynretvol}_t + \alpha_6\,\text{intangible}_t + \alpha_7\,\text{tradingvol}_t + \alpha_8\,\text{insti}_t + \alpha_9\,\text{btm}_t + \alpha_{10}\,\text{finconstraint}_t + \alpha_{11}\,\text{horizon}_t + \alpha_{12}\,\text{change_roa}_t + \alpha_{13}\,\text{change_eps}_t + \alpha_{14}\,\text{surprise_prioreps}_t + \alpha_{15}\,\text{gexp_average}_t + \alpha_{16}\,\text{bsize_average}_t + \alpha_{17}\,\text{year_dummy} + \alpha_{18}\,\text{industry_dummy} + \varepsilon$$

Robustness tests: ITCV tests, two-stage least squares regression, falsification tests

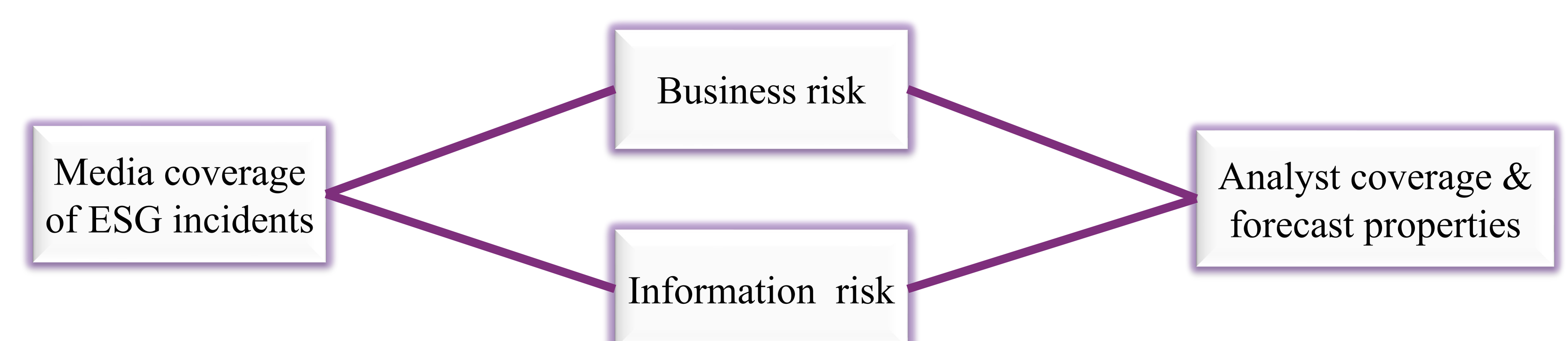

Figure 3. Mechanism

Results

- Analyst coverage is negatively associated with media coverage of ESG incidents.
- The negative association between media coverage of ESG incidents and analyst coverage is more pronounced for firms subject to high business risk, high information opacity, intense product market competition, and more severe media coverage of ESG incidents.
- Analyst forecast error and dispersion are positively correlated with media coverage of ESG incidents.
- Our mechanism tests further reveal that business risk and information risk are more pronounced for firms that are subject to media-covered ESG incidents, thereby explaining why analyst coverage is lower, and analyst forecast error and dispersion is higher, for these firms.

Implications

The reduced analyst coverage, along with the increased forecast error and forecast dispersion, implies the undermining of analysts' role as information intermediaries and plausible consequential reduction in the capital market efficiency. These thus underline the importance for regulators and board of directors to curb CSI, and for analysts to improve performance in the forecasting for socially irresponsible firms, particularly those that are subject to media coverage of ESG incidents.