Socially responsible investors derive non-financial utility from investing in accordance with their values and beliefs. Starks et al. (2018) find that institutional investors with longer horizons prefer high ESG-rated firms and behave more patiently, e.g., they do not immediately react to underpriced stocks or sell overpriced ones. Literature review reveals interesting results, with increasing demand for high ESG-rated companies.

Increasing relevance of CSR

Corporate Social Responsibility and Market Efficiency: Evidence from ESG and Misvaluation Measures

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Introduction

Increasing importance of Corporate Social Responsibility

- Sustainable investing becomes a worldwide trend.
- Increasing demand for high ESG-rated companies.

Starks et al. (2018) find that institutional investors with longer horizons prefer high ESG-rated firms and behave more patiently, e.g., they do not immediately react to underpriced stocks or sell overpriced ones. Literature review reveals interesting results, with increasing demand for high ESG-rated companies.

Research question & Contribution

- Does ESG lead to misvaluation of firms?
- Why is ESG engagement for overvalued companies increases the overvaluation?
- ESG engagement of undervalued companies lowers the undervaluation.

ESG effects on misvaluation measures

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<th>ESG effects on misvaluation measures</th>
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<td>Measure</td>
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<td>RES</td>
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<td>MSV</td>
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<td>RRV</td>
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Data & Methodology

- Data for misvaluation measures, the ASSET4 ESG score as well as control variables for 1,817 US companies are obtained from REFINITIV over the sample period 2004 - 2017.
- Residual income model (based on Michiel (2018)) & RRV-misvaluation model (Dong, Hirshleifer, and Teoh (2020)) is well-established in the corresponding literature (e.g., Starks et al. (2018)).
- Misvaluation (MSV) is calculated as a ratio of actual market value of equity to (imputed) true equity value:
  \[ MSV_{i,t} = \frac{M(t)}{V(t)} \] (1)
- Residual income model relies on Earnings Forecasts to approximate a true value.
- RRV misvaluation ‘true’ value as a function of a company’s Book value of equity, Net income and Leverage.

Empirical Analysis

- Panel data for the period 2004-2017 empirically analyzed based on fixed-effects estimations.

Analysis of most overvalued (top 20%) and undervalued (lowest 20%) firms

- ESG has positive effect on misvaluation ratios for both samples, but with different implications.
- ESG engagement for overvalued companies increases the overvaluation.
- ESG engagement of undervalued companies lowers the undervaluation.

The moderating role of information asymmetry

- Misvaluation-ESG relationship can be accompanied by impact of information asymmetry → prior literature shows that CSR engagement affects companies’ information asymmetry of firms.
- Proxies for information asymmetry: bid-ask spreads, illiquidity, volatility of I/B/E/S analysts’ earnings forecasts, forecast error of earnings forecasts → We do not observe a significant impact of information asymmetry.

Increasing relevance of CSR

- Google Trends’ Search Volume Index for sustainability topics as proxy for sentiment.
- Higher sustainability sentiment raises the misvaluation ratios induced by ESG

Robustness

- Robust to 2SLS instrumental variables estimations.
- Robust to dynamic panel GM estimates.

Conclusion

- Increase in a firm’s ESG score leads to a significant rise in its misvaluation measures.
- Increase in the ESG score expands misvaluation for overvalued firms (i.e., market inefficiency), but moves undervalued firms towards the true value (i.e., market efficiency).
- Sentiment towards sustainability intensifies the impact of ESG on misvaluation.

References


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