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The Impact of VIGEO Ratings on European Markets

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Motivations

- Growing interest in CSR and SRI
- Demand of investors for CSR ratings
- Unclear link between CSR and financial performance of firms
- Methodological difficulties
- **Use an event study to analyze the CSR impact on firm value**

Main questions

- What is the impact of CSR rating announcement **on stock prices?**
- Impact of the **informational content?**
  - A positive or a negative relationship?
  - Aggregated score?
  - How ***fields*** react? Difference among them?
  - What about sub-fields and items?
  - Due to a strength (+) or a concern (-)?

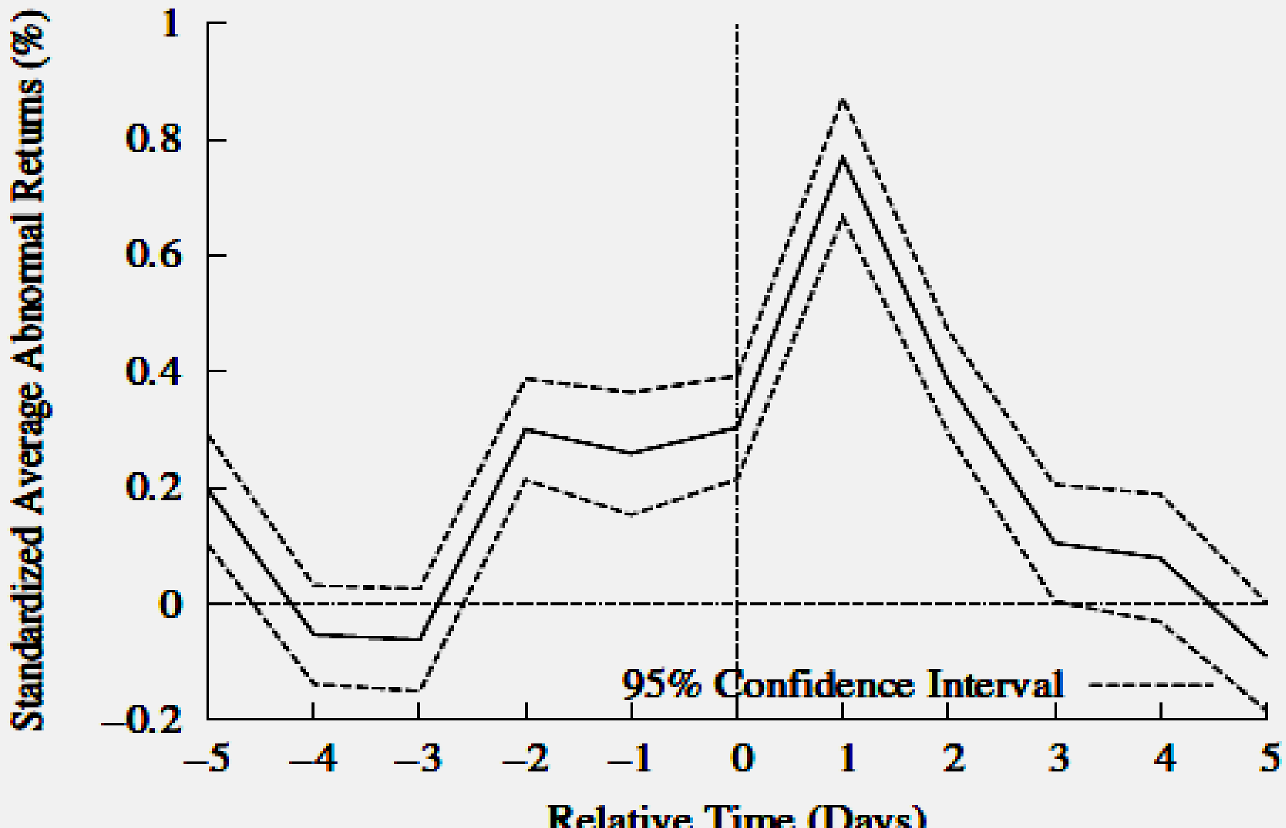
Sample

- Equitics© from 2004 to 2009: 1945 events
- Exclusion filters lead to a final sample :
  - 1,945 events
  - 778 firms
  - 17 countries
  - Between 1 and **4** ratings by firm
  - Between 1 and 88 ratings by trading day
- *Normal score transformation* from Vigeo score to enable comparison

Methodology : Event study

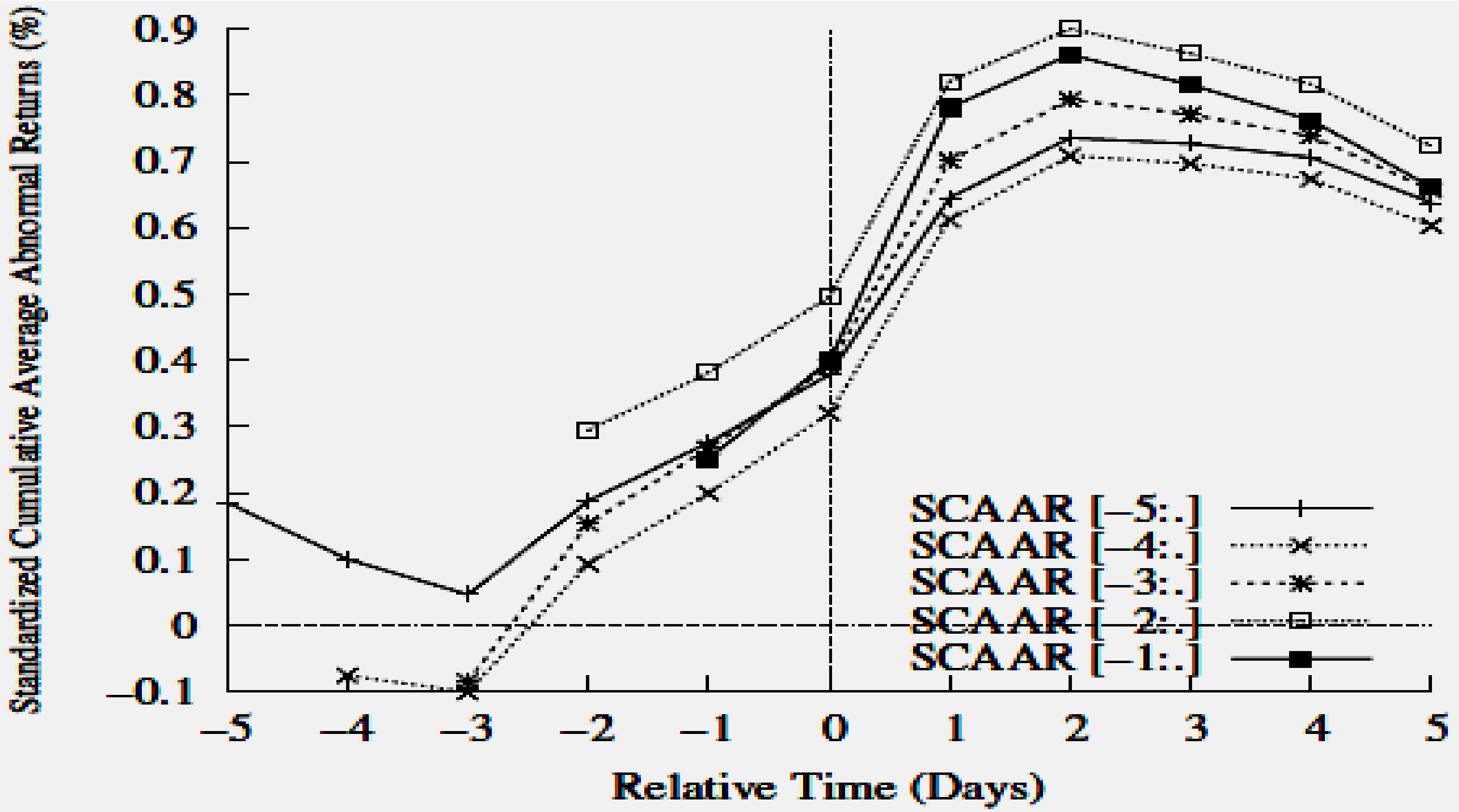
- Event date: announcement date or following stock trading day if the market is closed
- Estimation window : [-130; -10]
- Event window : **[-5; +5]**
- **4 factors model** (*Fama French, 1993; Carhart, 1997*)
- Computation and **standardization** of the **abnormal returns** (*Campbell, Lo & MacKinlay, 1997*)

Abnormal Returns



This figure shows Standardized Average AR (SAAR) in the event window. 95% confidence interval is built using a reverse t-test.

Cumulative Abnormal returns



This figure shows Standardized Cumulative Average AR (SCAAR) in the event window. The various SCAAR change only with respect to the beginning date.

Results and findings (set n°1)

- A positive **stock price reaction** to the announcement of ratings, whatever the score (good or bad)

  ↔ The announcement of social ratings is associated with an increase in firm value

- Our results show **the relevance of CSR information for investors**, and especially VIGEO ratings

Results and findings(set n°1)

- Another explanation : **portfolio re-balancing** of socially responsible institutional investors (to achieve a composition with companies having a good extra-financial score)

- An anticipated positive effect on stock prices, 2 days before ratings announcement

  ↔ semi-public collection data by Vigeo

  + “private” status of ratings

Regression methodology

1) **Filtering out the influence of firm financial features** from CSR scores

$$Score_{i,t} = \alpha + \sum_{s=0}^{9} DS_s \times (MV_{i,t-1} \times \gamma_{MV,s} + BTMV_{i,t-1} \times \gamma_{BTMV,s} + BETA_{i,t-1} \times \gamma_{BETA,s}) + \varepsilon_{i,t}$$

Where $Score_{i,t}$ designates any component of the rating : overall, fields, sub-fields and items

Regression methodology

2) **Linking CAR and corrected CSR scores**

$$CAR_{i,t} = \alpha + \beta \times CS_{i,t} + \gamma \times X_{i,t} + \varepsilon_{i,t}$$

where $CAR_{i,t}$ is the cumulative abnormal return of firm i on date t, $CS_{i,t}$ is the matrix of corrected scores of firm i, and $X_{i,t}$ is the matrix of the selected control variables.

Results and findings (set n°2)

- The overall Corporate Social Performance has no effect on markets

  ← Confounding effect of aggregated score

  (*in line with Vigeo disclosure policy)*

- Value effects are driven by a few detailed components of social responsibility…
- … and by expected benefits/costs or risks
  - being close to the average is sometimes rewarded (e.g., Quality of working conditions)
  - having a good *or* a bad score are both penalized, illustrating "sustainability risk" and "non- sustainability risk".
- Sub-fields are often the good measure level

Results and findings (set n°2)

- Human rights are value enhancing (reward of good scores)
- Both Human Resources and Environment are value destroying :
  - Human Resources : a good score $\Rightarrow$ negative reaction
  - Environment : reward of bad scores
- Mixed effects prevail for Business Behavior and Corporate Governance
- No effect for Community Involvement

Conclusion

- **The relevance of CSR ratings (and CSR information) for investors**

- **Value effects are driven by expected benefits/costs or risks of CSR**
- **Main effects :**
  - **Human Rights (+)**
  - **Human Resources (-) and Environment (-)**

Conclusion

- **Practical implications for investors**:
  - To properly measure benefits and risks associated with CSR
  - To focus analysis on a few disaggregated components of CSR
  - To integrate CSR into pricing models and asset allocation processes
- The consideration by investors of value effects and risk linked to ESG criteria could contribute to **some convergence of shareholders' and stakeholders' objectives**

Complementary research

- Study of transaction volume and bid-ask spreads on European markets (intraday data)

  $\Rightarrow$ Before the announcement, trading volume drops sharply while it increases afterwards, both effects compensating

- A broader dissemination of CSR ratings should improve market quality

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Thank you for your attention

Abnormal Volumes