Management Earnings Forecasts and Investor Trust: Signaling Effect of Corporate Social Responsibility

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Abstract

This study examines whether investor trust built through corporate social responsibility (CSR) activities affects the relationship between the accuracy of management earnings forecasts and investment performance, proxied by firm-specific returns and idiosyncratic risk based on Fama and French (1993) three factor model.

From a long-term perspective, firm-level investor trust-building may influence the association between management forecast reporting and market-based performance. The present analysis investigates how investors perceive CSR intensity, and how it influences investment performance in both market downturns and upturns in Japan during the period 2007-2016.

The main results are as follows. First, high accuracy of management forecasts is significantly related to high firm-specific returns and low idiosyncratic risk. Second, investors pay the cost of CSR activities in an upturn market but are rewarded by underpinned returns in a downturn market. Therefore, investors enjoy insurance benefits from highly-trusted companies, which help assure the stability of returns in the long run.

This study suggests that CSR strategies can be used by corporate managers to signal trustworthiness in the capital market and may contribute to restraining management bias in earnings forecasts reporting. This implies that non-financial disclosure may improve the outcomes of financial disclosure by affecting investors' attitudes.