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INSIDE THIS ISSUE

Managers' Pay Duration and Voluntary Disclosures

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Corporate managers are reluctant to disclose bad news in a timely manner because it has an adverse impact on their welfare. This paper examines the effect of managers' pay duration on firms' voluntary disclosures of bad news. Pay duration refers to the average period that it takes for managers' annual compensation to vest.

The authors hypothesize that managers with longer pay durations are more likely to issue bad news earnings forecasts because their interest is better aligned with that of shareholders, their welfare is less sensitive to short-term stock price drops, and they benefit more from enhanced disclosures. Consistent with their main hypothesis, the authors find that managers with long pay durations are more likely to issue bad news earnings forecasts than those with short pay durations. This result holds after they control for the endogeneity of pay duration using an instrumental variable approach. The authors' obtain the same inference whether they use an annual-based measure or a cumulative measure of pay duration. In the additional analyses, the authors find that their results are robust to an alternative measure based on options and stocks only. They also find that the results are robust to a change specification.

From cross-sectional analyses, the authors find that the positive effect of pay duration on bad news disclosure is more pronounced for firms with weaker monitoring and for firms with poorer information environment. These results suggest that pay duration plays a more important role in inducing managers to disclose bad news when the marginal benefits of additional disclosure are greater. Moreover, the study finds that the positive effect of pay duration is greater for firms facing less litigation risk and for firms operating in more homogenous industries, where managers' ex ante incentive to disclose bad news is relatively weak.

In addition, the authors find that forecasts issued by managers with longer pay durations are more accurate, suggesting that longer pay durations improve not only the quantity but also the quality of bad news forecasts. Additional tests indicate that the results are not driven by the alternative explanations that managers with long pay durations strategically disclose bad news earlier and withhold bad news later or that pay duration captures the potential non-linear relationship between equity-based compensation and disclosure.

The authors acknowledge that their analyses are subject to several limitations. First, it is possible that the results can still be affected by the potential endogeneity even though they address the issue in a couple of different ways. Second, while they obtain the same inferences using alternative measures, pay duration is not perfect in capturing managers' horizon. Third, management forecasts are only a part of the overall disclosure activities of a firm. Despite the above limitations, the results indicate that increasing pay duration, i.e., lengthening the vesting period of stock-based compensation, can effectively mitigate disclosure related agency problems and motivate managers to convey bad news more promptly. The importance of increasing pay duration is particularly salient for firms in which there is a greater need for improving voluntary disclosures.

The "Green" Geography: Corporate Environmental Policies and Local Institutional Investors

Johan Sulaeman (National University of Singapore), Abhishek Varma (Illinois State University)

Corporate environmental performance has a substantial geographical element. Motivated by recent studies viewing corporate policies as a reflection of local norms, the authors examine the clustering of corporate environmental performance as a function of local environmental norms. Corporate environmental performance is typically rated as positive performance (strengths) in which the firm contributes positively to the environmental conditions, and negative performance (weaknesses) in which the firm's operation is viewed as having a negative impact on the environment. The clustering in performance is mostly confined to corporate environmental weaknesses, rather than environmental strengths. These patterns are robust in subsample and sub-period analyses.

The authors then disentangle the effect of local norms that is not reflected in the prevailing local regulations. To do this, the authors focus on the toxicity levels of manufacturing facilities operated by firms with non-local headquarters. This analysis allows them to control for the local and regional environmental regulations at the facility location, and isolate the effect of the variation in local environmental norms at the firm's HQ location. The results indicate that the effect of local norms at HQ location persists even after controlling for local regulations.

The authors also document that violations of local environmental norms are associated with avoidance by local institutional investors in certain cities. This local avoidance is a crucial caveat to the pattern of overweighting of local stocks generally observed in investor portfolios. Whereas investors located in area with low environmental awareness overweight local stocks irrespective of the presence of corporate environmental concerns, investors located in environmentally friendlier areas appear sensitive to such concerns. Indeed, institutional investors located in "green" cities display a negative bias against local firms that violate local environmental norms.

The authors find that the relationship between corporate environmental concerns and firm relationship is stronger for firms located in relatively "green" cities. This pattern is consistent with local investors penalizing firms for violating local norms.

Table 4: Environmental and Corruption Ratings across Cities

This table summarizes the environmental and corruption ratings across 18 large cities in the U.S. *Avg # firms* refers to average number of firms in each Consolidated Statistical Area (CSA) over the period 2001–2013. *EnvConcern Rate* refers to the average percentage of firms with environmental concerns in each firm's city. Ind.-Adj. EnvConcern is the average of residuals obtained from annual cross-sectional regressions of EnvConcern on FF-10 industry dummies. To calculate Ind.-Adj. EnvConcern Rate, we average the *Ind-Adj EnvConcern* at the CSA-year level and then the average over time for each CSA. The *Green City Index* is obtained from the Siemens (2011) study, which was conducted by the Economist Intelligence Unit and commissioned by Siemens. It is based on the following nine criteria: CO2 emissions, energy, land use, buildings, transport, water, waste, air quality and environmental governance. The Corruption index is defined as the number of federal convictions for corruption-related crimes by elected officials, per million of population. The data on corruptions has been obtained from US DOJ's "Report to Congress on the Activities and Operations of the Public Integrity Section." Rankings for the Ind-Adj. EnvConcern Rate, EnvConcern Rate, Green City Index and Corruption Index are placed in brackets. For ease in interpretation, we rank the variables in different orders. A higher rank for EnvConcern Rate implies worse corporate environmental performance. A higher ranking for the Green City Index indicates a greener city. For the remainder of this study we use the variable "Green" to refer to this rank. A higher ranking for Corruption Index implies less corruption by elected official in the city. For the remainder of this study we use the term "Ethical" (i.e. less corrupt) to refer to this rank.

Consolidated Statistical Area (CSA)	Avg # Firms	Industry-Adjusted EnvConcern Rate	Raw EnvConcern Rate	Green City Index	Corruption Index
Worst Areas (by EnvConcern Rate):					
Detroit, MI	11.69	0.13 (18)	0.39 (18)	28.4 (1)	1.83 (12)
Pittsburgh, PA	13.85	0.08 (17)	0.35 (17)	56.6 (3)	2.16 (11)
Cleveland, OH	14.46	0.06 (16)	0.30 (16)	39.7 (2)	5.03 (3)
Atlanta, GA	22.08	0.06 (15)	0.20 (12)	57.8 (5)	2.53 (8)
Chicago, IL	56.69	0.05 (14)	0.22 (13)	66.9 (10)	4.92 (4)
Washington, DC	38.62	0.04 (13)	0.17 (10)	71.4 (12)	7.97 (1)
Charlotte, NC	9.23	0.03 (12)	0.29 (15)	59.0 (6)	1.66 (15)
New York, NY	137.92	0.02 (11)	0.14 (7)	79.2 (17)	4.30 (5)
Dallas, TX	40.15	0.02 (10)	0.20 (11)	62.3 (7)	1.69 (14)
Best Areas (by EnvConcern Rate):					
Philadelphia, PA	30.23	0.01 (9)	0.17 (9)	66.7 (9)	3.86 (6)
Denver, CO	21.15	-0.02 (8)	0.12 (6)	73.5 (15)	1.78 (13)
Minneapolis, MN	23	-0.02 (7)	0.15 (8)	67.7 (11)	1.18 (17)
Seattle, WA	16.31	-0.03 (6)	0.06 (3)	79.1 (16)	1.42 (16)
Boston, MA	41.46	-0.04 (5)	0.07 (5)	72.6 (14)	2.31 (9)
Los Angeles, CA	39.08	-0.05 (4)	0.05 (2)	72.5 (13)	2.27 (10)
San Francisco, CA	83.31	-0.06 (3)	0.04 (1)	83.8 (18)	1.00 (18)
Houston, TX	45.92	-0.06 (2)	0.26 (14)	62.6 (8)	3.24 (7)
Miami, FL	10.85	-0.07 (1)	0.06 (4)	57.3 (4)	5.39 (2)

valuation is influenced by local environmental norms. Prior studies provide empirical evidence linking poor corporate environmental performance and lower firm valuation. This study finds that this The authors find that corporate environmental strengths are also associated with lower firm value. This result may appear counterintuitive, but it makes sense in the presence of a reasonably large cost of going green.

Additionally, the authors find evidence that the presence of environmental strengths in company profiles may be an attempt to camouflage poor corporate environmental performance. In particular, firms located in "green" cities appear more likely to display environmental strengths in the presence of concerns. However, this behavior does not seem to mitigate the negative valuation effects associated with corporate environmental concerns.

The authors conclude that their results indicate that corporate environmental performance is related to local norms that capture the apathy towards the well-being of the local community. The results also indicate that corporate environmental performance could be one of the conditioning measures of local bias of institutional investors. The study documents novel evidence on the effects of local environmental norms on the link between environmental policy and firm valuation. The patterns observed are consistent with violations of local norms associated with lower firm valuations. Firms seem to be aware of this link, and consequently attempt mitigate this negative relation – albeit unsuccessfully.

Global Risks in the Currency Market

George Panayotov (Hong Kong University of Science and Technology)

In the currency market, risk factors are typically seen as global, i.e., affecting all economies and currencies. Global risks require compensation from the perspective of all investors, regardless of their home currency. Prior studies have considered global equity volatility risk; global currency volatility risk; global imbalance risk; global growth news risk; global macro risk, among others.

To investigate global risk factors, this study employs a novel cross section of currency trades, with largely the same returns from the perspective of any currency, and in particular focuses on a cross section of (numeraire-invariant) carry trades. It first presents a new empirical finding related to a widely considered global risk factor -- the US dollar -- using the invariant cross section. Namely, the average returns of the invariant carry trades are highly correlated with the betas of these trades with respect to a dollar factor, indicating that dollar and carry risks may be more closely related than assumed previously.

This finding is then examined within an established modelling framework where global risks play a major role. Importantly, the study suggests a modification that can reconcile the model with the data, while preserving the original model calibration. Specifically, in this modification, the sensitivities of various economies to one of the global factors are made time-varying, and the dispersion of these sensitivities is dependent on the relative US risk-free rate.

The study suggests an econometric test that evaluates empirically a large number of previously considered global risk factors, while reflecting the predictions of the modified model. The role of the model is to impose discipline in the search for global risk factors and their economic interpretation.

It is found that only few combinations of previously considered variables are not rejected by the test, and even they fall short in some dimensions. The global equity market factor stands out as only one which can qualify for the factor with time-varying sensitivity. The study also finds that the risks in the currency market can also be linked with the global financial cycle in Rey (2015). Overall, global risks still pose a challenge for the empirical research of the currency market.

Panda Games: Corporate Disclosure in the Eclipse of Search

Kemin Wang (Fudan University), Xiaoyun Yu (Indiana University), Bohui Zhang (The Chinese University of Hong Kong, Shenzhen)

In this paper, the authors study how firms adjust their disclosure strategies depending on the efficiency of information transmission in capital markets. The authors show that firms strategically alter their disclosure behaviors when the channel to transmit information is severed. They conducted textual analysis and exploited an exogenous event -- Google's 2010 surprising withdrawal from mainland China, which significantly hampered domestic investors' ability to access foreign information. Following Google's exit, Chinese firms' announcements on their foreign transactions become more bullish in comparison to similar announcements prior to the exit and to those that involved only domestic transactions. This effect is mitigated in the presence of foreign investors or analysts affiliated with foreign brokers, who are not subject to foreign information censorship by the Chinese government. Moreover, firms with existing foreign operations issued rosier annual reports after Google's departure than those that operate only domestically.

The authors then explore the welfare consequences of a bullish disclosure on events about which investors can no longer easily acquire information and validate. As the misinformation in disclosure rises, earnings quality declines significantly. In addition, insiders sell more shares and earn higher returns during the announcement period when press releases about foreign events or annual reports from firms with foreign operations become more optimistic. Overall, the study provides causal evidence consistent with the notion that firms distort their disclosure to take advantage of the weakened information environment.

This paper contributes to a growing literature in finance examining the role of information intermediaries. For example, researchers have documented the real outcomes of business news media and financial analysts. In particular, several papers show that the interruption of the printing and delivery of news media affect information asymmetry, return volatility and local trading. Instead of asset pricing, in this study the authors focus on corporate disclosure and explore how managers take advantage of the disruption of information flow through managing the rhetoric in press releases and insider trading.

Overall, the results of the study indicate that the efficiency of transmission technologies imposes a potential constraint on manipulation by firms, and thus plays an important function in facilitating investors' information production. The findings also highlight the role of formal institutions in shaping the information environment and call for the urgency of their development in the emerging markets.

Spillovers in Asset Prices: The Curious Case of Haunted Houses

Utpal Bhattacharya (Hong Kong University of Science and Technology), Daisy Huang (Southwestern University of Finance and Economics), Kasper Meisner Nielsen (Copenhagen Business School and Hong Kong University of Science and technology)

This interesting paper focuses on spillovers – the notion that the consequences of an economic activity can affect third parties – in asset prices that has gained attention following the global financial crisis. The interest among academics, market participants and policy makers has intensified because liquidation of assets can lead to downward spirals or cascades in asset prices and net worth of market participants and creditors, resulting in real effects through reduced investment and output.

To convincingly document that spillover effects in asset prices can be driven by a change in the perceived quality of the asset, the authors identify an idiosyncratic negative shock – a unit being declared as "haunted" due to a murder, suicide or other unnatural death. They analyze the spillover effect on prices of neighboring houses, and examine whether it is driven by the price pressure channel, the change in perceived quality channel, or both. Separating these two channels is possible in the setting, because the authors can observe nearby house prices, irrespective of whether the affected unit is sold or not, allowing them to identify spillover effects driven by a change in the perceived quality of the asset.

For their study the authors analyse Hong Kong's residential real estate market as its offers features that help their identification strategy. To examine the effect of haunted houses on prices the authors follow a standard approach in real estate economics and regress the logarithm of the price on apartment characteristics, apartment fixed-effects, and year-calendar month fixed effects. They find that affected units sell at an average discount of 20% after they become haunted. Apartments on the affected floor sell for an average discount of 5%, while apartments in the same block sell at an average discount of 3%. Finally, apartments in the same estate sell at a modest discount of 1%.

The documented ripple effects of haunted houses suggest that the tragic event induces a negative spillover effect on the prices of nearby apartments. Amongst the tragic events that the authors consider, murder has the most dramatic ripple effect. Significantly, price recovery is slow. The authors find that in their panel that prices of the haunted units do not seem to recover at all during the 16-year sample period. The prices of its affected neighbors in the same floor, block or estate, do recover, albeit very slowly.

The main result of this study is that a large fraction of the spillover effect in prices is driven by a perceived quality channel. The authors document this by comparing the spillover effect when the affected unit is sold to spillover effects when the affected unit is not sold. On the affected floor, most of the 5 percentage point decline in prices is caused by the change in the perceived quality channel. For apartments in the affected block or estate, the quality channel accounts for about half of the discount, while the price pressure channel accounts for the other half. To this end, this study is the first to identify a spillover effect, through the perceived quality channel, over and above the price pressure channel.

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- to connect globally prominent academic researchers, practitioners and public policy decision-makers on Asia-Pacific related financial and economic issues;
- to enhance the research capabilities and development of strong clusters of finance and economic research groups in academic institutions and other institutions in Singapore and Asia-Pacific.

This Digest summarizes selected papers presented in the ABFER 6th Annual Conference which was held in May 2018 at Shangri-La Hotel, Singapore. More information on the conference can be found here.

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