

Investor Relations und Transparenz

Eine empirische Analyse

Bachelor Thesis
in
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Executive summary

When, in 1953, General Electric Co. created the first department of Investor Relations, not many financial agents thought it would become such an important element for the company. Today Investor Relations and Transparency are fundamental components of GE and many other firms, which invest large sums in these activities. This is due to the increased information requirements that investors demand as a result of the globalization of the capital markets, and also because balance sheet Transparency and communication of key information are a strong signal for the market (Meier and Sigrist (2006)). In that regard, the key question of my Bachelor Thesis is whether Transparency and Investor Relations have influence on a firm's value. To do this, I split my work in two parts: a theoretical, where I analyze the most important papers studying the link between voluntary disclosure (an important element of Investor Relations) and company's value and between corporate governance and firm's value; and an empirical part, wherein I analyze many relationships (firms' size, sector and stock's return) during the 1990-99/00 decade.

In the theoretical part of my work I research the most important papers in this field, finding many compositions on the theme of "voluntary disclosure and firm's value" and "Corporate Governance and firm's value". Basically, from these papers I can find that there are different ways to affect the company's value, the most cited are four of them. The first three do this through stock liquidity, cost of capital and analysts following (Healy and Palepu (2001)) and one uses Tobin's Q as direct measure. Thus, I analyze the most important papers on each one of these ways and study the methodology and the results.

In the empirical part of my Bachelor Thesis I test the Swiss market by studying firms quoted on the Swiss Exchange (SWX Swiss Exchange or Berne Exchange (BX)) from January 1990 to December 1999¹. The data for this analysis is provided by two sources: "Aktienführer Schweiz" and Datastream. The first is a publication of the Swiss Journal "Finanz und Wirtschaft" that analyzes all listed companies. Every year and for every firm I extrapolate three key numbers: *Turnover*, *Number of employees* and *Market value* (observed shortly before the publication). In addition the books assign an Investor Relations Rating and a Transparency Rating (divided in eight classes: A, A-, B+, B, B-, C+, C, C-) that I use as reference variable for all my analysis. Datastream provides the companies' sector, the Return Index and the monthly Market value that I use in the last part of my Thesis. I divide the analysis in three parts: at first I analyze the relationship between Investor Relations Rating and the firms' sector and secondly I study how this relates with the companies'

¹ In the first part of the decade 1990-99/00 there were separated Exchanges (Zurich, Geneva, Basel and Bern). Starting from 1995 only two: the SWX Swiss Exchange (from 2008 SIX Swiss Exchange) and the Berne Exchange (BX) (Meier and Sigrist (2006)). For simplicity purposes in this Bachelor Thesis I will refer only to this two Exchanges.

size. I conclude my analysis studying the connection of Investor Relations and Transparency Rating with the stock's return.

In the first study I examine the sample at my disposal to find which sectors, on average, are more present than other. With an average sample of 241.3 companies I find that more than 55% of these is represented by *Financials* (30.1%) and *Industrials* (25.1%). The next step is to find the average sample distribution over the Investor Relations Rating. I note that 74% of all firms are in the middle of the rating scale, with a *B+* (28.1%) , *B* (28.5%) or *B-* (17.2%) but it is immediately clear that these values are affected by *Financials* and *Industrials*. In fact, by analyzing the specific sectors' distribution, I see that firms in these two categories take up almost all the middle score positions. Finally, I analyze the relationship between Investor Relations Rating and the firms' sector. To avoid that the weight differences between sectors affect the study I use a specific methodology: I assign a factor to each rating (*A*=8, *A-*=7, *B+*=6, *B*=5, *B-*=4, *C+*=3, *C*=2, *C-*=1) and multiply it by the number of firms within the sector that have a corresponding rating, obtaining a final value. I repeat this process every year and for every sector. Finally I sum all final values of a sector and divide them by the number of firms in this sector. Thus, I obtain the average rating for each sector. In this way, I note that in nearly every case sectors tend to have a rating between *B* and *B+*. *Healthcare* has the best average score (6.00) and *Telecommunications* the worst (2.5). At this stage it is interesting to study the evolution of Investor Relations over the 1990-99/00 decade. Did firms consider this element always equally important/unimportant during the sample period? Did companies consider it important only in the first years of the decade and less in the later ones? In line with the theory I find that all sectors improve their score in year 99/00 compared with 1990. In particular, *Basic materials* show the largest improvement (+44%) and *Healthcare* the smallest (+9%). When focusing on annual changes, I discover that the scores are subject to fluctuation and therefore there is not always an increase in the Investor Relations Rating, but also a decrease. As we shall see this fact finds an interpretation in the theory.

In the second part of my empirical study, I examine the relationship between the Investor Relations Rating and the firms' size. The variables I use as size indicators are *Turnover*, *Number of employees* and *Market value*. At first I calculate the correlations between them, in order to forecast the results of the relationship: are e.g. *Turnover* and *Market value* positively and strongly correlated? This means that if a company with a high *Turnover* is in the top ratings, it will also have a high *Market capitalization*. Consequently the table will have large numbers on the Top and small values on the bottom. To the contrary, if the correlation is negative and firms with a great *Turnover* have an *A*, I expect small *Market values* to top the ratings (namely *A* and *A-*) and a large value at the bottom (*C+*, *C* and *C-*). The results indicate that these three variables move together and are

connected. The last step is to analyze if large companies, that are (as seen in the correlations analysis) those with high *Turnover*, *Number of employees* and *Market value*, fill the Top or the bottom of the ratings. Thus, I calculate the average value of each variable for all ratings, from *A* to *C-*, from 1990 to 99/00. I immediately note that bigger firms hold the top positions of the rating, whereas smaller ones are at the bottom. Furthermore, in case of *Market value*, the results, starting from *C-*, rise progressively from rating to rating, up to *A*. The same also applies to *Turnover*, with one exception: a mismatch between *B* and *B+*. For *Number of employees*, the trend is less evident, especially in the middle of the table, but still present. Lastly, to show this connection more clearly, I consider only the three categories *A*, *B* and *C*. The results confirm the rule: companies' size matters, because there is an evident distribution of values over the Investor Relations Rating.

The third part of my empirical research analyzes the relationship of Investor Relations Rating and Transparency Rating with the stock's return. The keys questions are: can investors benefit from great Transparency and Investor Relations? and also: will investors earn an excess return by picking portfolios of firms with high Transparency or Investor Relations? To examine this relationship I follow standard portfolio analysis approaches, as suggested in the work of Eugster and Wagner (2010), from January 1990 to December 99/00. Based on the Transparency Rating and Investor Relations Rating I build five portfolios: *Top portfolio* (comprises company stocks with ratings *A* and *A-*), *B+ portfolio*, *B portfolio*, *B- portfolio* and *Bottom portfolio* (with *C+*, *C* and *C-*), where the *Top portfolio* contains stocks with excellent Transparency respectively Investor Relations and the *Bottom portfolio* those with bad Transparency respectively Investor Relations. I construct a sixth portfolio, called *Spread portfolio*, to see what happens if an Investor decides to go long in the *Top portfolio* and short in the *Bottom portfolio*, and therefore if stocks of firms with excellent Transparency respectively Investor Relations outperform those of firms with a bad rating. The study, based on the Carhart portfolio analysis regression model (RMRF, SMB, HML, WML), occurs for both equally-weighted and value-weighted construction. For portfolios based on Transparency Rating (value-weighted approach) I find a high and significant excess return for both *Top portfolio* (16,90%) and *B+ portfolio* (11.07%) showing that investors are rewarded not only by excellent Transparency but also by a good one. For Investor Relations Rating portfolios I find high abnormal returns for *Top portfolio* (15.27%), *B+ portfolio* (12.55%) and *B- portfolio* (14,43%). This last result represents a surprise because it shows that the market rewarded a low rating too. However a positive and significant alpha in the Top part of rating is a novelty with respect to other similar works (e.g. Eugster and Wagner (2010)). The *Spread Portfolio* shows in nearly every case negative (and insignificant) alphas and this may be due to large companies, which, given the high financial resources, tend to invest too much in this element obtaining the opposite result: they

destroy value. Lastly I conclude my work by analyzing small companies, studying if the market, given the lack of information about them, rewards those with greater Transparency or Investor Relations. To do this I calculate the average value of the Total assets value of 329 Swiss firms for every year during 1990-99/00. Then for both firms below (small companies) and above (large companies) the average I construct three portfolios' groups: *Top portfolio*, *B+ portfolio* and *Medium portfolio* (comprises company stocks with ratings *B+*, *B* and *B-*). The results, unlike the theory and the work of Eugster and Wagner (2010), show in nearly every case that big companies have better returns than small ones. Specifically for portfolios based on the Transparency Rating I find positive and significant alpha for the *Top portfolio* of small companies (10.90%) that is however smaller than the alpha for the comparable portfolio of large firms (16.48%). Furthermore, besides being greater, the returns of the *B+ portfolio* (22.78%) and *Medium portfolio* (21.37%) of big corporations are significant, unlike those of small firms. The equally-weighted approach shows the same tendency: large companies always have a better alpha, that is also significant in the case of the *Medium portfolio* (10.17%). Apart from a higher and significant excess return in the value-weighted *B+ portfolio* (12.03%) of small firms, portfolios based on Investor Relations Rating of large companies have better abnormal return, that is even significant for both *Top portfolios* (value-weighted: 17.38% ; equally-weighted: 12.55%).

I conclude my Bachelor Thesis, resuming all results and trying to find possible explanations that may justify them.