Sustainability-Forward-Looking Disclosure and Stock Liquidity: A European Investigation

Imen Derouiche[1], Melanie Luxembourger[2], Anke Müßig[3]

Université du Luxembourg, Luxembourg

Abstract

This study examines the effect of sustainability-forward-looking disclosure (SFLD) on stock liquidity. The accounting literature documents the prominent role of forward-looking disclosure in mitigating information asymmetry between the firm and the market. However, the specificities of SFLD as prospective information make its effect on information asymmetry and, thus, on stock liquidity debatable. On the one hand, as voluntary information, SFLD contributes to mitigating adverse selection and transaction costs, implying lower information asymmetry and, thus, higher stock liquidity. On the other hand, SFLD encompasses information with relatively extreme uncertainty, long-horizon predictability and low verifiability, which is likely to exacerbate information asymmetry and, hence, lower stock liquidity. On the basis of a content analysis approach, we measure the quality of SFLD with reference to the time-horizon precision: the more precise the time-horizon predictability, the higher the SFLD quality. Studying a large sample of 13,253 observations of firms from Western European countries from the 2003-2022 period, we find that better quality of SFLD is associated with higher stock liquidity, meaning that such information contributes to alleviating information asymmetry among traders. The results of channel tests indicate that decreased information asymmetry implied by greater financial analysts' coverage and lower forecast errors are plausible sources for the effect of SFLD on stock liquidity. Overall, we provide sound evidence consistent with the contribution of SFLD to the corporate information environment despite all the rhetoric about the market perception and expectation of sustainability.

Keywords: Sustainability Disclosure, Stock liquidity, European Firms, Forward-Looking Disclosure