

Most firms neglected to include pandemic in annual risk assessments despite warning signs, study shows

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Public companies in the United States are required to file annual reports that, among other things, disclose the risk factors that might negatively affect the price of their stock.

The risk of a pandemic was known prior to the current health crisis, yet managers, in disclosing their companies' [risk factors](#) to shareholders in 2018, showed little foresight in terms of the impact and likelihood of a pandemic, according to new research from the University of Notre Dame.

In "Management Disclosure of Risk Factors and COVID-19," Bill McDonald and Timothy Loughran, finance professors at Notre Dame's Mendoza College of Business, examine all 10-K filings (annual reports filed with the Securities and Exchange Commission) from 2018, before the current pandemic, and find that less than 21 percent of the filings contain any pandemic-related terms.

"Pandemic risk was well known before today's crisis and we now know the impact for shareholders is significant and negative for the majority of companies," McDonald said. "Given management's presumably deep understanding of their businesses and general awareness that, for at least the past decade, pandemics have been identified as a significant global risk, the percentage of firms listing it among other low-probability events, like earthquakes, asteroids and volcanoes, should have been higher."

McDonald and Loughran applied their [ongoing research](#), which utilizes textual analysis to gauge the tone of financial documents, to the coronavirus pandemic. And while they found many firms listed other low-probability events among potential risks, McDonald says legitimate warnings about pandemics dominated any real concerns about other types.

"Of course, hindsight makes things obvious," McDonald said, "but I think the risk of a pandemic was significant and, more importantly, it has the potential to cause more damage to most firms. A small portion of those firms, including Disney and Carnival Cruise Lines, acknowledged

the risk."

Stock values have taken an enormous hit as a result of the pandemic, and McDonald says managers should have known better.

"Health organizations and reputable news sources had been emphasizing that a [pandemic](#) was a likely event," he said. "Informing shareholders of all potential risks associated with investing in a company is a critical part of the disclosure process. Perhaps companies need to go beyond standard templates in identifying unusual but relevant events that could impact the value of their firm."

More information: Tim Loughran et al. Management Disclosure of Risk Factors and COVID-19, *SSRN Electronic Journal* (2020). [DOI: 10.2139/ssrn.3575157](#)

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