

Management Earnings Forecasts - Does Corporate Governance Matter?

Presented by

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Corporate Governance & Corporate Disclosure



- ❑ Regulatory perspective:
 - ❑ Higher quality corporate governance → higher quality corporate disclosure in terms of timeliness and balance of disclosures
- ❑ Finance and economic theories:
 - ❑ Higher quality corporate governance structure → an optimal corporate disclosure policy (Shleifer and Vishny, 1997; Core, 2001)
- ❑ Empirical evidence:
 - ❑ Mixed evidence
 - ❑ Depending on what types of disclosures are examined

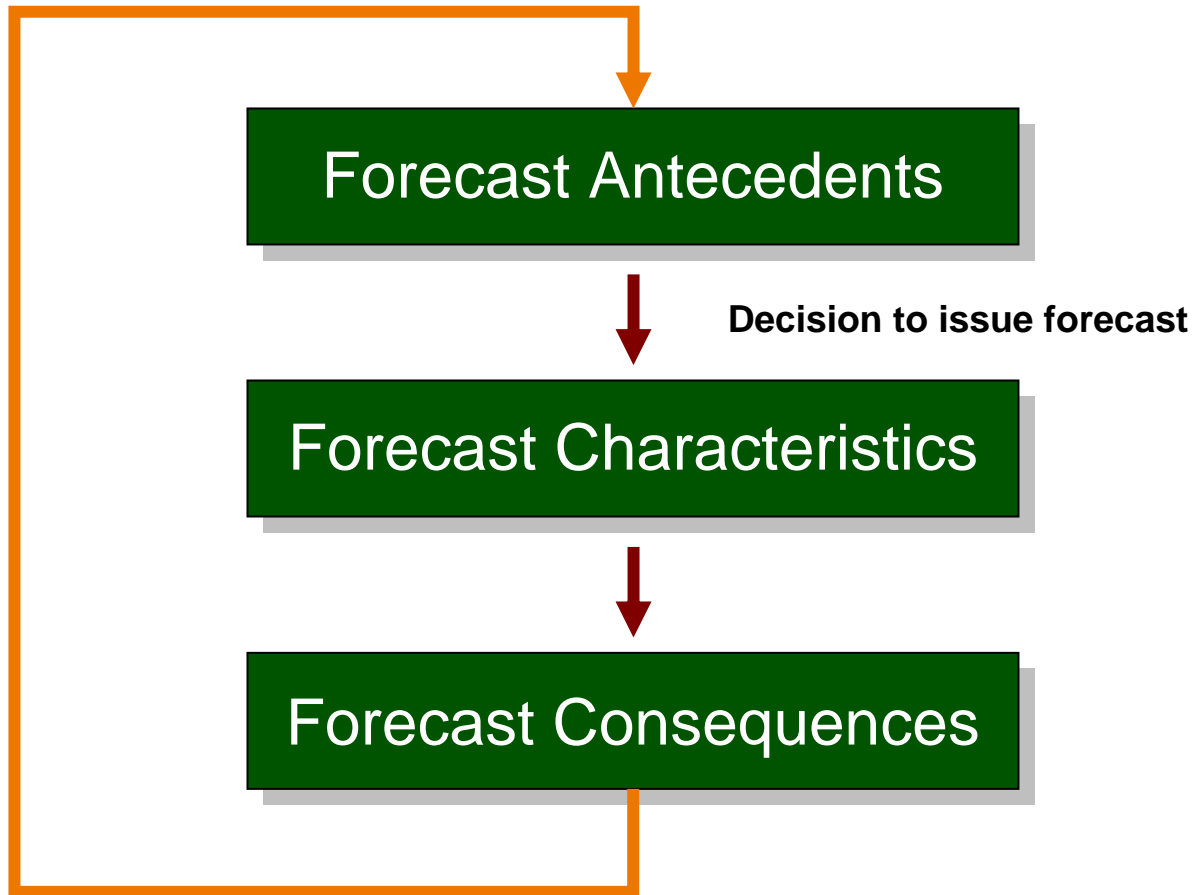
Does corporate governance make any difference to corporate disclosure behaviour?

Corporate Governance & MEF



- ❑ Management earnings forecasts (MEF) are regarded as an important part of corporate disclosure policy
 - ❑ Especially in New Zealand where few firms are followed by analysts
- ❑ Investigate the impact of corporate governance on corporate decision to issue MEF, their characteristics and consequences

A Framework for MEF



(Hirst et al., 2008)

Forecast Antecedents



- ❑ External corporate governance mechanisms
 - ❑ Legal and regulatory environment
 - ❑ Analyst following
 - ❑ Block and institutional ownership
- ❑ Internal corporate governance mechanisms
 - ❑ Board characteristics (size, independence, expertise, committee structure, CEO/chairman duality, ownership and compensation)
 - ❑ Managerial incentives (ownership and compensation)
- ❑ Other firm-specific characteristics
 - ❑ Information asymmetry between firms and the market
 - ❑ Firm-specific litigation risk (size, return variability, earnings news and industry membership)
 - ❑ Proprietary costs of information
 - ❑ Prior forecasting behaviour

Forecast Characteristics



- ❑ Frequency
- ❑ Good news vs. Bad news
- ❑ Precision
- ❑ Accuracy and Bias
- ❑ Stand-alone vs. Bundled
- ❑ Timing

Forecast Consequences



- ❑ Share price reaction
- ❑ Analyst reaction

Legal and Regulatory Environment



- ❑ MEF characteristics are different in high litigation environments
 - ❑ Baginski et al., 2002
- ❑ Changes in regulation are found to impact on MEF characteristics and consequences
- ❑ However, the results vary depending on firm-specific characteristics
 - ❑ Johnson et al., 2001 (U.S. PSLRA 1996)
 - ❑ Bailey et al., 2003; Heflin et al., 2003; Wang, 2007 (U.S. Reg FD 2000)
 - ❑ Chan et al., 2007 (Australian CD regime 1994)
 - ❑ Truong et al., 2008a-c (New Zealand CD regime 2002)

Analyst Following



- ❑ MEF characteristics and consequences are different for firms followed by analysts
- ❑ Number of analysts following does matter
- ❑ However, results vary for individual MEF characteristics and consequences
 - ❑ Ajinkya et al., 2005
 - ❑ Karamanou and Vafeas, 2005
 - ❑ Truong et al., 2008a-c

Block and Institutional Ownership



- ❑ Block ownership and institutional ownership influence MEF characteristics and consequences differently
- ❑ Results vary depending what MEF characteristics and consequences are examined
 - ❑ Bamber and Cheon, 1998
 - ❑ Truong et al., 2008d
 - ❑ Ajinkya et al., 2005
 - ❑ Karamanou and Vafeas, 2005

Board Characteristics



Mixed evidence obtained for the impact of board characteristics on MEF characteristics and consequences, depending on:

- ❑ Individual board characteristics
- ❑ Individual MEF characteristics and consequences
- ❑ Different legal environment
 - ❑ Ajinkya et al., 2005
 - ❑ Karamanou and Vafeas, 2005
 - ❑ Chan et al., 2008
 - ❑ Truong et al., 2008d

Managerial Incentives



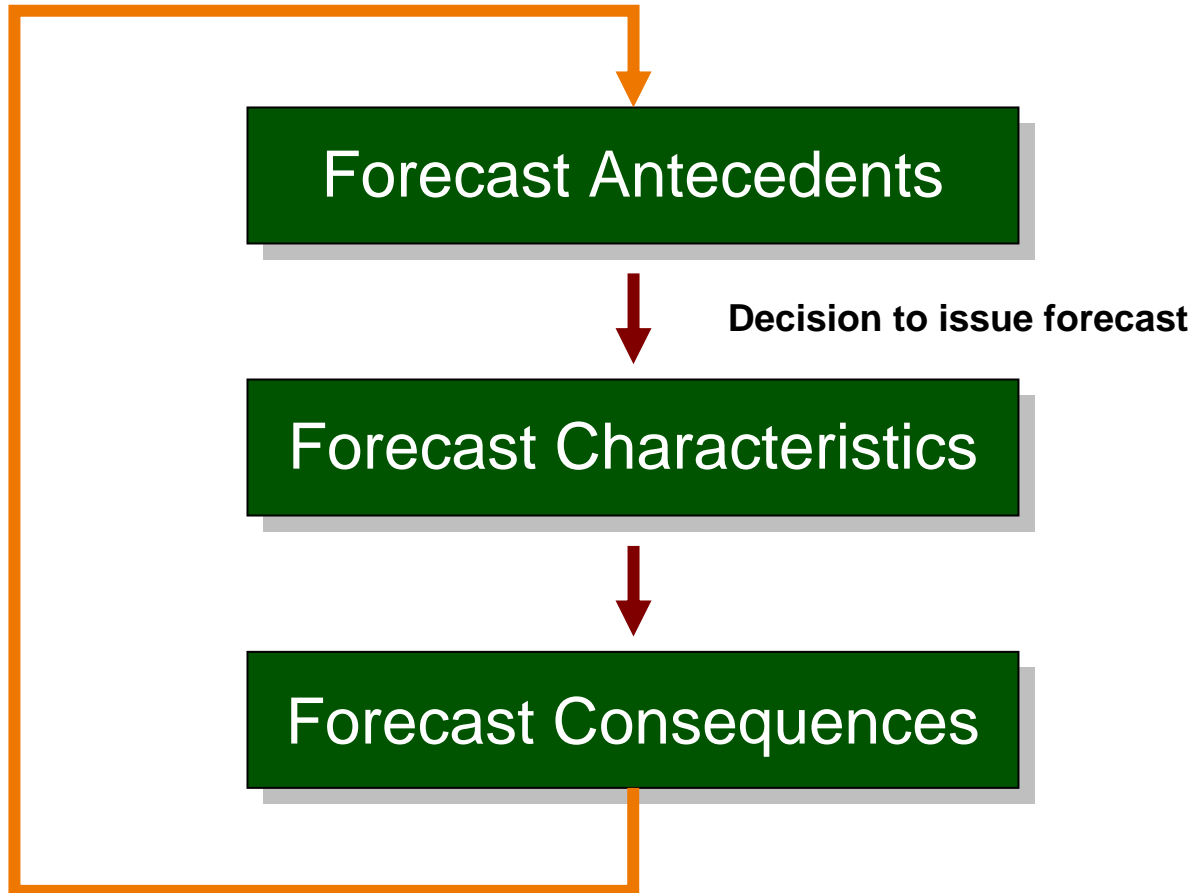
- ❑ Firm-specific managerial incentives significantly impact on the decision to issue and determine the news content of MEF
- ❑ Firms issue MEF for reasons consistent with managers' self-interest or incentives
 - ❑ Nagar et al., 2003
 - ❑ Aboody and Kasznik, 2000

Other Firm-specific Characteristics



- ❑ Firms with higher information asymmetry are more likely to issue MEF
- ❑ Firm-specific litigation risk does influence the decision to issue MEF
- ❑ The impact of proprietary costs on MEF characteristics is mixed
- ❑ Firms' prior forecasting behaviour is found to influence MEF characteristics and consequences

A Framework for MEF



(Hirst et al., 2008)

Conclusion



- ❑ Academic research provide support for the role of both external and internal corporate governance mechanisms in determining corporate decision to issue MEF, their characteristics and consequences
- ❑ The evidence that external corporate governance mechanisms such as increase in regulation and litigation risk play a role is more consistent
- ❑ However, it is difficult to conclude at this stage that external corporate governance mechanisms are better given the limitation of both research design and data availability