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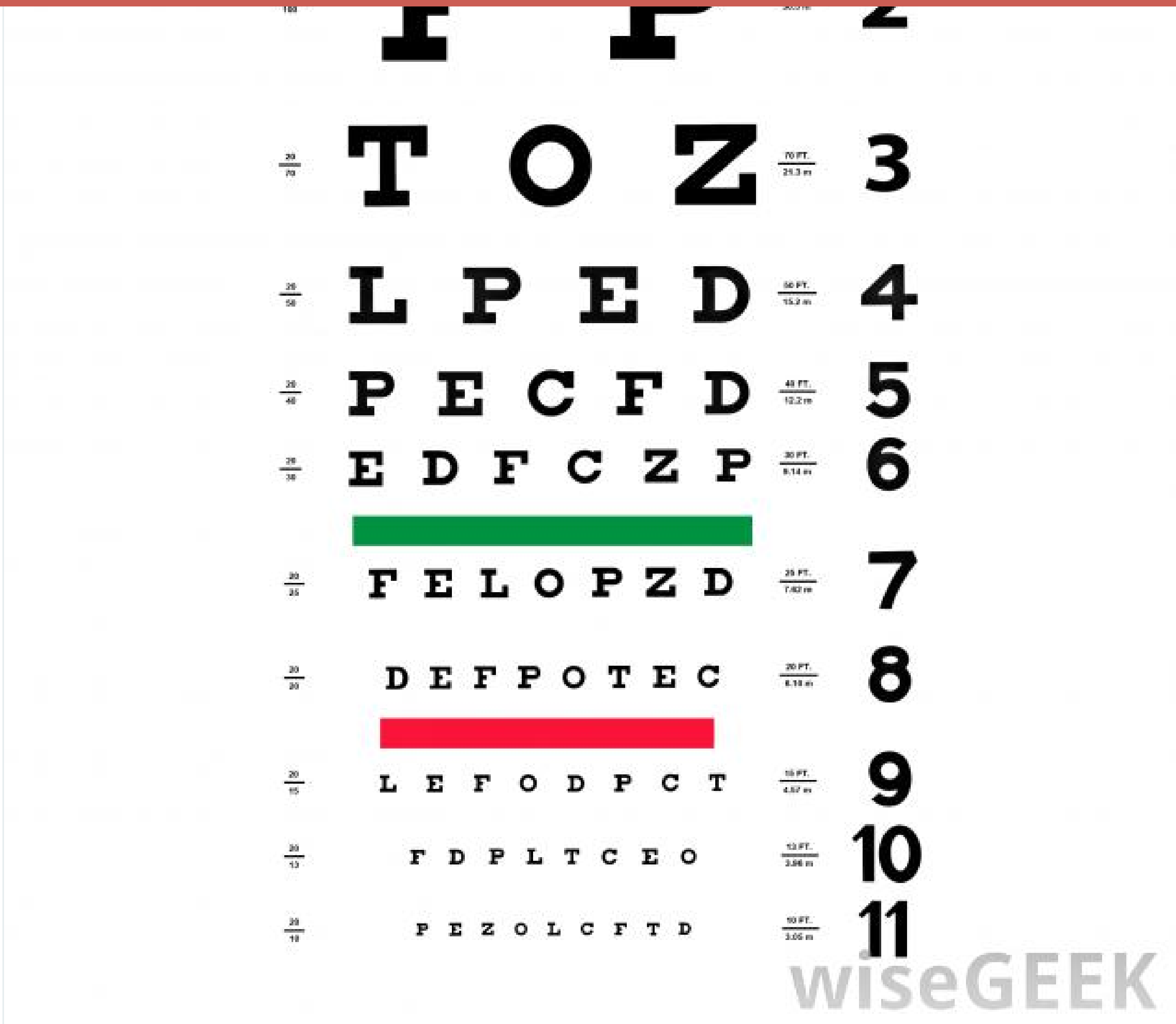
Jan. 22, 2018



"We needed to remove the temptation to work only toward the next set of numbers … Better decisions are being made. We don't have discussions about whether to postpone the launch of a brand by a month or two or not to invest capital, even if investing is the right thing to do, because of quarterly commitments. We have moved to a more mature dialogue with our investor base."

Thus has Paul Polman, the CEO of the British/Dutch multinational Unilever,

quarterly financial statements. And, while it may be possible to compare the effects of reporting frequency across countries, it would present the daunting challenge of untangling those effects from ones due to other variations in institutional and regulatory environments.

Now a scholarly study goes a long way to remedy the lack of evidence on this issue.

A paper to appear shortly in ***The Accounting Review***, published by the **American Accounting Association**, finds a basis for comparing the experience of American firms by using data from periods when reporting-frequency mandates were changed in the U.S., so that before-and-after comparisons can be made.

While acknowledging that there may very well be advantages in increased reporting frequency – such as lower cost of capital and more information for investors – the study concludes, crucially, that shorter reporting intervals engender "managerial myopia" which finds expression in a "statistically and economically significant decline in investments" along with "a subsequent decline in operating efficiency and sales growth."

Therefore, "our evidence…supports the recent decision by the EU and the UK to abandon requiring quarterly reporting for listed companies with an apparent intent to preventing short-termism and promoting long-term investments," write the study's authors, Rahul Vashishtha and Mohan Venkatachalam of Duke University's Fuqua School of Business and Arthur G. Kraft of the Cass Business School of City University London.

The professors report that, when new regulatory mandates forced companies to increase the frequency of their financial reporting, they reduced their annual capital investments by about 1.5% or 1.9% of their total assets, depending on how capital investments are defined. Considering that the average annual capital investments of

intervals) enjoyed 1) annual sales that were about 10% greater as a percentage of assets than sales of the latter group; 2) annual sales growth that was about 3.5% greater; and 3) return on assets that was about 1.5% greater. By contrast, in the period three to five years post-mandate, as a result of declines in the firms with reduced reporting intervals, sales and sales growth were about the same for the two groups, while the difference in return on assets was down to about 1%. As one would expect, the researchers' analysis controls for an array of factors known to influence the three performance variables, including company size, profitability, leverage, and investment opportunities.

The professors also report that investment declines following reporting-frequency increases were seen principally in industries where capital investment takes some time to generate increased earnings, such as the manufacture of cars and trucks or of electrical or business equipment, and occurred much less, if at all, in industries that see earnings gains from investments relatively quickly, such as personal and business services, apparel-making, and manufacture of health-care products.

The authors take note of research by other investigators that found no material effect on investment decisions from the EU's imposition of required quarterly reporting in 2007, a mandate eliminated in 2014. As the professors observe, however, the interim management statement (IMS) required by the EU "unlike the quarterly reporting requirement in our setting...requires firms to provide only *narrative* disclosures on the financial position and performance of the firm rather than mandating disclosure of financial-statement information...Thus, the setting of the IMS does not fully capture the forces associated with quarterly reporting."

Rather than considering their research at odds with the earlier study, the professors view them as complementary. An IMS, they say, may very well represent a practical compromise between mandated quarterly financial reporting and no such quarterly requirement at all, since it provides at least some information for investors without

with a company that had already been reporting at the mandated interval. The study's conclusions derive from comparing annual investments and performances of the two groups in the five years before and after the mandates, while controlling for known factors that affect the relevant variables.

The performance declines uncovered in the study lead the authors to ask "why managers behave myopically when it ultimately hurts firm performance, and ultimately their own welfare, over longer horizons." To appreciate the problem, they write, "consider a capital investment made by a firm either to upgrade its manufacturing technology...or to penetrate a new market segment. It may take more than a quarter or two for such an investment to increase sales...and hence [it will] not be reflected in near-term earnings...A manager who is sufficiently concerned about a short-term decrease in stock price might not make such an investment to begin with."

The professors compare the situation to that classic of game theory, the prisoner's dilemma, in which two members of a gang are arrested and imprisoned separately. If the two remain silent, both will face a lesser charge; but each will face the harshest penalty permitted if he remains silent while his confederate betrays him on the chance of avoiding punishment entirely.

Similarly, a lack of trust between managers and investors can lead to the unfortunate results uncovered in the current study. As the researchers write, "Both managers and investors would be better off if managers did not behave myopically. However, such an equilibrium is not sustainable: even if investors conjecture no myopia, managers still have an incentive to fool them while behaving myopically."

The study, entitled "Frequent Financial Reporting and Managerial Myopia," is scheduled for the March issue of ***The Accounting Review***, published six times yearly by the **American Accounting Association**, a worldwide organization devoted to excellence in accounting education, research, and practice. Other journals published