New research in the June issue of Accounting Horizons, a journal of the American Accounting Association, finds this answer to vary considerably among five major business ...

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In the calculations of equities traders, probably no measure of corporate performance garners more attention than companies' success or failure in meeting the earnings forecasts of analysts. Yet, important though earnings results are to investors, they are hardly foolproof guides to stock performance on a reporting day.

Many are the occasions where companies report meeting or beating earnings

have almost double the sensitivity to reported revenues (revenue response coefficient, or RRC) that stock prices of firms in other sectors have. In other words, their stocks rise or fall twice as much as other stocks do in response to the amount revenues diverge from what analysts predicted. In the words of the study, "A cross-sector comparison reveals that the RRC for high-tech and health sectors is almost twice of that for the consumer, manufacturing and miscellaneous other sectors."

These differences aside, what is true for all five sectors is the propensity of companies to exactly meet or slightly beat analysts forecasts *in conformity with the priorities of investors*.

Thus, in the new study's analysis of quarterly financial reports over a sixteen-and-a-half year span, 16% of firms reported revenues that barely met or slightly exceeded analysts' revenue forecasts following quarters of high RRCs (that is above the median); in contrast, only about 9% of firms did the same following quarters of low RRC.

But the pattern was strikingly reversed when it came to earnings sensitivity (earnings response coefficient, or ERC). Here 15% of the firms reported revenues that barely met or slightly exceeded analysts revenue forecasts following quarters of low ERC, while only 11.5% did so following quarters of high ERC.

"Clearly, corporate managers are attuned to what investors are looking for in their companies' reports and to the weight investors assign to revenues as distinct from earnings," said accounting assistant professor Rong Zhao of the University of Calgary, who carried out the study. "And, to a considerable degree, the revenues they report reflect this."

What to make of this finding? Prior research, the professor notes, has described the way managers oscillate between an all-growth strategy, where revenues take priority, and a margins strategy, where earnings do. "But," she adds, "given the fact

A similar motivation is also at work, her findings suggest, for companies at relatively early stages of development. Defining firms' life cycles on the basis of three factors – dividend payout, sales growth, and age – Prof. Zhao classifies those below the average life cycle of companies in their sector as relatively young. Being relatively young, she finds, strengthens the positive association between companies' RRC and meeting revenue benchmarks.

The study's findings are based on financial data involving 6,836 public companies in the aforementioned five business sectors over a period of 16 ½ years. Market-adjusted stock gains or losses were obtained for the three-day windows around quarterly earnings and revenue announcements, and ERCs and RRCs were calculated from the relationship between those results and the divergence of reported earnings and revenues from the levels forecasted by analysts. Then the relationship was analyzed between the RRCs and ERCs and the extent of revenue surprises (that is, how much reported revenue diverged from analysts' forecasts) in the following quarter.

To make this final analysis, Prof. Zhao divided revenue surprises above and below zero into 62 bins, with each one representing a tiny increment or decrement (0.15% of equity) from the adjoining one. By far the largest proportion of revenue surprises were not actually surprises at all, since they were found in the zero bin, which represented results that exactly met analysts' forecasts or were a tiny amount (0.15% of equity) above it. As indicated earlier, results in that bin accounted for about 16% of the total when RRCs were high but only about 9% when RRCs were low, leading Prof. Zhao to write:

"The unusually high frequency of small positive revenue surprises...suggests that firms attempt to cross the thresholds of revenue forecasted by analysts. More importantly, the propensity to meet or just beat revenue benchmarks is higher (lower) when the investor pricing of revenue (earnings) is high."

As for where the counterpoint between earnings and revenues is today, the professor

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