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Managers:

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“It’s been five full years since I called BS and declared war...against [this] stupid,

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latitude in how they describe performance of their firms...and if things later turn south, managers may claim in court that their prior statements were mere ‘puffery.’ ”

This hazard notwithstanding, the new paper in *The Accounting Review*, a peer-reviewed journal of the American Accounting Association, goes on to find that “investors appear to largely treat extreme language as an informative signal, as it stimulates significant trading activity and generates strong price reactions.”

And, wonderful to relate, this receptiveness largely pays off for investors. As the new study concludes, extreme language is not principally a reflection of management style or a way to spread hype or mislead investors. Rather, it “is positively associated with future earnings and sales. In contrast, moderate language exhibits no or weak association with future performance...[M]anagers appear, on average, to use extreme language to convey information about future operating performance.”

The effect of this strong language is substantial, according to the research by Khrystyna Bochkay of the University of Miami, Jeffrey Hales of the University of Texas at Austin, and Sudheer Chava of Georgia Institute of Technology. Enlisting individuals through a crowd-sourcing Internet marketplace to judge the linguistic extremity of words uttered in earnings conference calls, the researchers find that a mere 1.33% increase in extreme words conveying optimism results in about a 6% increase in trading volume in a stock and a 0.63% boost in price over three days. As the study notes, these represent increases above and beyond those attributable not only to actual financial results but also to the linguistic tone of executives’ comments, as measured by proportions of positive to negative words.

Thus does the paper take a sizable step beyond a large body of research on the effects of linguistic tone in various kinds of financial reporting – prior studies that focused on the relative preponderance of positive and negative words without considering how strongly expressive they are.

The new research also finds that the extra boost in share prices that occurs when

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What about conference calls when earnings fall short of forecasts? Strong expressions of optimism can to some extent be effective then too, according to the study, making impressions on investors and helping limit shareholder losses.

In addition, to its impact on investors, linguistic extremity significantly affects professional stock analysts as well. The professors find that it increases both the magnitude of forecast revisions and the proportion of analysts undertaking revisions. In the words of the paper, “analysts react to extreme language in earnings calls more strongly than they do to more moderate language... [A]nalysts, similar to investors, attend to the type of language used in conference calls and, at least on average, find the nuances of language to be informative.”

The study's findings derive from a massive effort at linguistic analysis that involved categorizing words in transcripts of 60,940 earnings conference calls, including both the introductory remarks and the Q&A sections. Individuals from an Internet crowd-sourcing marketplace that is frequently used in social-science research were tasked with ranking by linguistic extremity nouns, verbs, adjectives, and short phrases. The result: a dictionary of 23,355 words and phrases, each scored on a scale of -5 (strongly negative) to +5 (strongly positive). Examples are as follows:

- +5: terrific, excellence, incredible, amazing
- +3: solid, effective, accomplishment, strengthen
- +1: competitive, encourage, steady, transparency
- -1: limitation, heavy, undue, step back
- -3: difficult, volatile, underperform, unfavorable
- -5: terrible, default, devastate, worst

With ratings in hand, the researchers constructed ways to measure the proportion of linguistic extremity in transcripts, defining positive extreme words as those scored at +4 and +5 and negative extreme words as those at -4 and -5. Words rated at 1, 2, and 3

were classified as moderate – positive or negative, as the case might be. They then set

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involved in earnings conference calls, they might want to resist pressures from their legal departments to dampen their language when circumstances seem to warrant speaking out strongly. Indeed, our results suggest that many executives, to their credit, are voicing their convictions in earnings calls, and this appears to help with price discovery.”

The new study, “Hyperbole or Reality? Investor Response to Extreme Language in Earnings Conference Calls,” is in the March issue of *The Accounting Review*, a peer-reviewed journal published six times yearly by the American Accounting Association, a worldwide organization devoted to excellence in accounting education, research, and practice. Other journals published by the AAA and its specialty sections include *Auditing: A Journal of Practice and Theory*, *Accounting Horizons*, *Issues in Accounting Education*, *Behavioral Research in Accounting*, *Journal of Management Accounting Research*, *Journal of Information Systems*, *Journal of Financial Reporting*, *The Journal of the American Taxation Association*, and *Journal of Forensic Accounting Research*.

Accounting • Technology

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