

## **Whether the Analyst Reports Change Managers' Behavior?**

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### **Abstract**

*Recent reports in the business press allege that managers take actions to avoid negative earnings surprises. We hypothesize that certain firm characteristics are associated with greater incentives to avoid negative surprises. Results show that there is pervasive pessimistic bias in management forecasts, management successfully induces analysts to lower their earnings expectations to an achievable level. We also find that firms with higher institutional ownership, higher value-relevance of earnings, high-growth prospects and a long string of meeting or beating expectations are more likely to meet or exceed expectations at the earnings announcement.*

**Key words:** Financial analysts; forecast guidance; earnings management

### **1. Introduction**

Financial analysts are important information intermediaries in capital markets. They provide information that has investment value, as demonstrated in a substantial body of research. The usefulness of analyst research potentially derives from two sources: the discovery of private information and interpretation of public information (Jegadeesh,2004; Asquith et al.,2005). Existing research on equity analysts focuses on analysts' role in investment and studies how analysts affect investors' decisions and stock price. However, only limited research has been done on analysts' role in corporate governance. How does the presence of analysts affect managers' behavior? This paper attempts to study these questions in the context of financial reporting. Specifically, the paper examines whether analyst coverage affects firms' earnings management behavior.

Previous research has already shown that analysts have significant influence on investor behavior. Managers perceive analysts as one of the most important groups affecting the share price of their corporations (Graham,Harvey,and Rajgopal,2005). But it is unclear what effect analyst coverage exerts on earnings management. On the one hand, analysts can be deemed to be external monitors of managers (Jensen and Meckling, 1976; Healy and Palepu, 2001). With training in finance and substantial industry background knowledge, analysts track corporate financial statements on a regular basis. They usually interact directly with management and raise questions on different aspects of earnings numbers through earnings release conferences. They have been directly involved in the discovery of corporate fraud in companies in the world such as Compaq Computer, CVS, Gateway, Motorola, Yingguangxia, Lantian Company. On the other hand, analyst coverage is often held responsible for creating excessive pressure on managers to manage earnings. In capital markets, increased coverage is usually accompanied by increased pressure on managers to perform. Firms that miss analyst forecasts usually suffer significant declines in their stock price.

Research suggests that meeting or beating analyst forecasts became the most significant benchmark for managers (Brown & Caylor, 2005). This could result from the markets' increasing focus on just meeting analysts' expectations (because these forecasts are becoming more accurate and precise) or from increases in the number of analysts and in the media attention paid to their forecasts. Bartov,and Hayn (2002) found firms that 'just meet or beat' current analyst earnings expectations enjoyed a higher stock return.

Similar results were reported by both McNichols (2002) and Lopez & Rees (2002). Failure to meet or beat forecasts was associated with significant adverse consequences. Matsunaga and Park (2001) found a significant negative incremental effect on the CEO's bonus where managers failed to meet quarterly earnings forecasts. Given the significant benefits (costs) associated with just meeting (failing to meet) analyst forecasts benchmark, managers are no longer passive in the earnings game. Rather, they are actively trying to win the game by altering reported earnings and/or influencing analyst expectations. Meeting benchmarks boosts management's credibility by meeting stakeholders' expectations and avoiding costly litigation that could potentially be triggered by unfavorable earnings surprises (Bartov et al., 2002).

The evidence of earnings management to 'just meet or beat' analyst forecasts, comes primarily from the studies conducted in the United States of America (hereafter US). Whether this finding can also be generalized to the China reporting environment needs to be assessed in light of at least two questions, namely whether (a) investors value analyst forecasts as a gauge of managerial performance; and whether (b) just meeting or beating analyst forecasts results in a value premium for China companies. There is a dearth of evidence in the China context to answer these questions. The available evidence has investigated the factors associated with forecast accuracy and bias, but there is hardly any evidence on the information content of analyst forecasts error. Shi (2007) found that precision of analysts' earnings forecast is enhanced by increasing in the numbers of analysts and by improving on earnings predictability and information disclosure. Chu (2008), using consensus forecast data from 2000 to 2005, found that analyst IPO price forecasts were, on average, more accurate than random model. Hope (2003), in an international study, found that strong enforcement regimes lead to higher forecast accuracy. The findings from the present paper could provide indirect evidence of the value of analyst services in the China context. It is expected that managers will engage in costly earnings management to 'meet or beat' analyst forecasts only when they find it beneficial to do so.

Earnings management to 'just meet or beat' analyst forecasts is a phenomenon that is strongly shaped by the business reporting environment. Reporting environments in the US and China differ in some important respects, and the threat of litigation faced by corporate managers is an important attribute of such differences. In particular, consistent evidence of earnings management to 'just meet or beat' analyst forecasts in the US has been attributed to, among other factors, the excessive threat of litigation. In particular, high-tech stocks have been extremely vulnerable when they fall below analyst forecasts benchmark (Skinner & Sloan, 2002). However, the lack of legal class-action privileges, and the entitlement of successful defendants to cost recovery from the plaintiff, has discouraged investors from suing corporate managers in cases of poor firm performance in China.

Furthermore, analyst following of China companies has not been intensive. For the year 2003, forecast data for only 573 companies were available in the Wind, which represented a merely 30% of the total number of domestic listed companies.

Additionally, US-based research on 'benchmark-beating' has strongly established that stock option-based executive compensation schemes were among the most important determinants of managerial incentives to 'just meet or beat' analyst forecasts (Cheng & Warfield, 2005). The extent to which these findings also hold in China is not clear because of the lower analyst coverage of China companies and a lack of evidence on the usefulness of long-term incentive packages.

In an international context, O'Brien (1988) raised concerns about whether analysts' ability to forecast earnings is important outside the US. She argued that financial statements in some countries are prepared to satisfy legal requirements, rather than to inform investors. However, in China this consideration is less relevant because of the separation of financial from tax reporting. China belongs to a tradition where investors rely on publicly disclosed accounting information to make investment decisions. China provides analysts with an incentive to engage in private information acquisition, because their service is demanded by the market. These factors suggest that investors might use analyst forecasts to evaluate managerial performance. The contrasting perspectives on the value of analyst services in China outlined here, therefore, justify an empirical examination of whether managers manage earnings to 'just meet or beat' analyst forecasts.

Using analyst forecasts data from the Wind for 2003 to 2011, I test a number of hypotheses about managers' incentives to avoid negative earnings surprises by examining the association between proxies for these incentives and the probability that the firm meets or beats analysts' forecasts at the earnings announcement.

As predicted, the results suggest that firms with the following characteristics are more likely to meet or exceed analysts' expectations: (1) higher institutional ownership; (2) greater value-relevance of earnings; (3) high-growth prospects; and (4) Long string of non-negative earnings surprises. These associations exist even after controlling for other factors associated with the probability of meeting or exceeding analysts' expectations, including the time analyst make forecast, firm size, and the magnitude of the initial forecast error.

The paper proceeds as follows: the next section presents the background for the study and a brief description of the related literature. Section 3 explains the research design issues. Sample selection procedure is discussed in Section 4. Section 5 provides the findings and Section 6 concludes.

## **2. Literature review**

Prior studies find that the market penalizes companies for reporting negative surprises. For example, Skinner and Sloan (2002) find that the market reaction to negative earnings surprises is much stronger than the market reaction to positive earnings surprises. Brown and Caylor (2005) suggest that the costs associated with negative surprises increased in the 1990s. They find that since the mid-1990s, but not prior to then, investors have penalized firms for missing analysts' forecasts more than for reporting losses or earnings decreases. On the other hand, the market appears to reward firms for meeting or beating expectations, even by small margins. Lopez and Rees (2002) find that the market penalizes firms for not meeting analysts' forecasts and rewards companies for meeting expectations, even after controlling for the magnitude of unexpected earnings. Kasznik and McNichols (2002) also document a positive association between meeting analysts' expectations and firm value. Given the increased costs for negative surprises and the rewards associated with positive surprises, managers' desire to meet or beat analysts' expectations appears to be rational.

Recent research suggests that managers manipulate earnings in order to meet or beat analysts' forecasts. Degeorge et al. (1999) present evidence that managers try to report earnings that meet or beat analysts' forecasts. Burgstahler and Eames (2001) also find a dearth of small negative earnings surprises and attribute it to earnings management. However, another way to meet or beat analysts' expectations is to guide analysts' expectations downwards to a level that the company can meet or beat in addition to earnings management. Indirect evidence of expectations management appears in recent studies. Consistent with the argument that firms manage sell-side analysts' forecasts downwards. Matsumoto(2002) investigates the characteristics of firms exhibiting evidence of strategic guidance. Bartov et al. (2002) suggest that firms which meet or beat analysts' earnings expectations enjoy a higher return than firms that fail to meet earnings expectations even in the cases where meeting or beating expectations is likely to have been achieved through expectations management. Brown and Higgins (2005) further document that US managers guide analysts' forecasts downwards relatively more often than do managers in other countries, and managers' guidance of analysts' forecasts has increased temporally around the world.

However, the current evidence on managing expectations is necessarily circumstantial since prior research proxies analysts' forecast errors for firm provided guidance. The exception is Soffer et al. (2000) which provides direct evidence of pessimistic guidance. However, they do not investigate how analysts respond to managers' pessimistic guidance, nor do they examine what firm characteristics are associated with pessimistic earnings forecasts. Therefore, it is warranted to directly examine management's earnings guidance to test whether analysts comply with management's guidance and to determine which firm characteristics are associated with pessimistic earnings guidance, and what factors affect the manager behavior .

## **3. Hypotheses development**

A manager is likely concerned that a negative earnings surprise will lead to significantly lower stock prices and adversely affect his or her performance evaluation. Puffer (1991), for example, find that the probability of CEO turnover increases with the shortfall of actual earnings from analysts' expectations. To the extent institutional investors overemphasize near-term profits (Porter 1992; Business Week 1987), managers of firms with higher institutional ownership likely perceive greater costs to missing analysts' forecasts. Frequently cited reasons for institutional investors' focus on current earnings include pressure for near-term portfolio performance; difficulty in analyzing all the stocks in a highly diversified portfolio; and the need for a defensible measure for trading due to their fiduciary responsibilities (Eames 1995). Because earnings surprises are readily available from a number of sources, they are a simple, defensible heuristic on which to base trades, and institutional investors likely react strongly to negative earnings surprises.

Lang and McNichols (1997) present evidence consistent with institutional investors trading based on earnings surprises. Moreover, because the business press focuses more heavily on earnings surprises than on intervening forecast revisions, the former is more likely than the latter to improve the appearance of portfolios at quarter-end, giving managers of firms with greater institutional ownership an incentive to guide forecasts down-ward to avoid negative earnings surprises. The empirical, survey, and anecdotal evidence suggests that managers of firms with higher institutional ownership have greater incentives both to manage earnings and to guide forecasts, leading to the following hypothesis:

H1: Firms with higher institutional ownership are more likely to take actions to avoid negative earnings surprises.

To test this hypothesis, I use the percent of total shares owned by institutions (%INST) as reported in the Wind.

A firm's economic circumstances are also likely to influence its managers' perceptions of the benefits of avoiding negative surprises at the earnings announcement. For example, if the value-relevance of a firm's earnings is low (i.e., earnings are a poor indicator of future cash flows and firm value), then shareholders likely react less strongly to negative earnings surprises; hence, managers of such firms are likely to be less concerned about failing to meet analysts' expectations:

H2: Firms with low value-relevance of earnings are less likely to take actions to avoid negative earnings surprises.

To test this hypothesis I use two measures of value-relevance. The first is a dummy variable indicating firms that report losses before extraordinary items. Prior studies demonstrate a lower association between returns and earnings (Hayn 1995) for loss firms. Prior research also suggests that meeting or beating analysts' expectations is less important for firms that incur losses (Degeorge et al. 1999) and that analysts' forecasts are more optimistic for loss firms (Brown 2001). In contrast to these prior studies, I suggest that an underlying firm characteristic (low value-relevance of earnings) explains the association between losses and the tendency to avoid negative surprises. Consequently, I do not measure the existence of a loss in the same quarter as the forecast error, but rather use a lagged measure of consistent losses. I expect a negative relation between LOSS and the tendency to avoid negative earnings surprises. The second measure of value-relevance of earnings, an industry-specific R2 from a regression of 12-month returns on earnings, captures industry-specific differences in the value-relevance of earnings. Prior studies suggest the value-relevance of earnings may be lower in certain industries, particularly high-technology industries (Amir and Lev 1996; Franzen 2000). To compute this measure, I regress excess daily returns (cumulated from three days after the quarter t-4 earnings announcement to three days after the quarter t earnings announcement) on the change in earnings per share from quarter t-4 to quarter t, scaled by price per share at the end of quarter t-4. I run regressions by year. Given the potential for measurement error with this variable, I use the yearly decile rank of the industry's R2 measure as the proxy for value relevance (EARNRET). I expect a positive relation between EARNRET and the tendency to avoid negative earnings surprises.

Managers of high-growth firms likely have greater incentives to avoid missing earnings expectations. Collins and Kothari (1989) show the market reaction to earnings announcements is greater for firms with high-growth opportunities. In addition, Skinner and Sloan (2001) find that the asymmetry in the market response to positive vs. negative earnings surprises is stronger for high-growth than for low-growth firms. Thus, managers of high-growth firms are likely to have strong incentives to avoid negative surprises. Moreover, a firm with high long-term growth forecasts may be able to maintain a "buy" recommendation from analysts despite a lower initial short-horizon forecast because analysts' stock recommendations are more closely related to the firm's long-term growth, rather than to its short-horizon forecasts (Band et al. 1995). Therefore, keeping expectations low to avoid negative earnings surprises is likely to be less costly for high-growth firms:

H3: Firms with high-growth prospects are more likely to take actions to avoid negative earnings surprises.

To test this hypothesis, I use the consensus long-term growth forecast outstanding at the end of quarter t-1 as reported in Wind estimate history (LTG).

Barth et al. (1999) present evidence that firms reporting increasing earnings receive a higher earnings multiple and Myers et al. (2005) provide related evidence that firms with long strings of non-decreasing earnings per share have greater incentives to continue the trend.

McNichols (2002) suggest that the market rewards firms meeting expectations, and the reward is withdrawn when firms fail to meet expectations again. Thus, we expect that firms with a long string of meeting or beating expectations are more likely to dampen analysts' expectations in order to avoid a negative earnings surprise.

H4: Firms with a long string of non-negative earnings surprises are more likely to be pessimistic in their management forecasts.

To test this hypothesis, SURP is the percentage of consecutive positive earning surprises in the eight quarters prior to the analyst forecast quarter. We expect that the longer the string of positive earning surprises, the more likely for management to dampen expectations.

## 4. Empirical results

### 4.1 Descriptive statistics

I classify firm-quarter observations as either meeting or exceeding expectations (MEET=1) if reported earnings meet or exceed the forecast outstanding at the earnings announcement ( $E^{REP} \geq F^{EA}$ ) or as not meeting expectations (MEET= 0) if reported earnings fall short of expectations ( $E^{REP} < F^{EA}$ ). In addition, firms in regulated industries likely have different incentives than those in non-regulated industries; therefore, I exclude financial institutions, utilities. All the variables require data from Wind. I measure most of the independent variables with a lag (i.e., prior to quarter t) to strengthen the argument over the direction of causality. Also, any contemporaneously measured proxy variable that includes a component of firm performance will likely be correlated with the probability of a positive earnings surprise if there is an unexpected shock to earnings (i.e., extreme good or bad performance is more likely to surprise analysts). This correlation would exist regardless of any management actions to avoid negative surprises and would therefore bias my results.

I also include three control variables, one to control for firm size, and two to control for uncertainty in the forecasting environment. Prior research also suggests that larger firms have less optimistic biases in analysts' forecasts (Brous 1993; Brown 1997). Thus, I control for size using the log of the market value of equity. Finally, I control for uncertainty in the forecasting environment because it is likely more difficult for managers to guide analysts' forecasts when uncertainty is high. At first, I include the absolute value of the initial forecast error, deflated by price at the end of the prior year as a measure of forecasting uncertainty. I compute the initial forecast using the first forecast each analyst made within 90 days after the earnings announcement from the same quarter of the previous year (i.e., approximately nine months before the end of the quarter) using Wind individual estimate history file, and the same time, we measure TIME with the number of days between the analyst forecast date and the earning announcement dates, scaled by 360.

Table 1: Trend over Time in the Probability of Meeting or Exceeding Analysts' Expectations vs. the Seasonal Change in Earnings

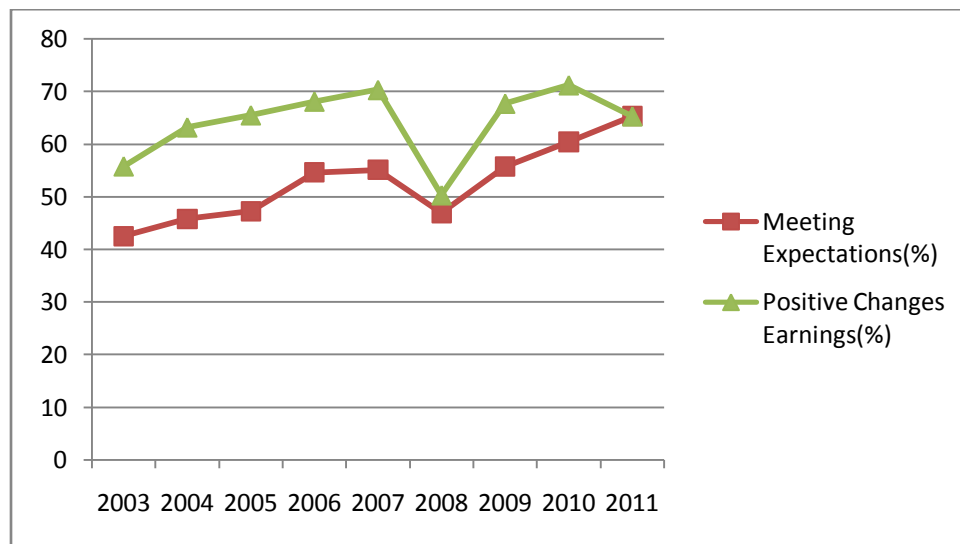
Year	Meeting Expectations(%)	Positive Changes Earnings(%)
2003	42.5	55.8
2004	45.8	63.2
2005	47.2	65.5
2006	54.6	68.1
2007	55.1	70.3
2008	46.9	50.3
2009	55.7	67.7
2010	60.4	71.2
2011	65.3	65.3
Spearman Rank correlation	0.906	0.195
p-value	0.001	0.663

The majority of financial press accounts of managers' downward guidance have appeared in the last few years; therefore, the proportion of quarters with positive earnings surprises is likely to have increased in recent years. Using Wind earnings surprise file, I compute the percentage of firm-quarters where actual reported earnings ( $E^{REP}$ ) meets or exceeds the consensus forecast outstanding at the earnings announcement ( $F^{EA}$ ) for each year from 2003 to 2011.

Table 1 reports the results of this analysis. Similar to the findings in Brown (2001) and Richardson et al. (1999), both of which are based on data from Wind, the percentage of quarters in which earnings met or exceeded analysts' expectations has increased over time (Spearman rank correlation = 0.906,  $p < 0.001$ ), consistent with growing emphasis on avoiding negative earnings surprises.

The increase is unlikely to be due to analysts underestimating the effect of positive macroeconomic events on firm profits. Table 1 shows that there is no significant trend over time in the percent of quarters with increases in earnings per share before extraordinary items from the same quarter in the previous year (i.e., the seasonal change in earnings). Thus, the tendency to meet or exceed analysts' consensus forecasts does not appear to result from a general increase in earnings performance that analysts failed to anticipate. Figure 1 plots the trend in these two percentages, which appear to move together in the first half of the sample period. The foregoing evidence is consistent with anecdotal reports suggesting managers take actions to avoid negative earnings surprises, particularly in recent years. In the next section I discuss firm characteristics that are likely associated with the incentive to meet or exceed analysts' forecasts.

**Figure1: Trend over Time in the Probability of Meeting or Exceeding Analysts' Expectations vs. the Seasonal Change in Earnings**



#### 4.2 Descriptive statistics

Descriptive statistics on the dependent, incentive, and control variables appear in Table 2. The average for the dependent variable (MEET) indicates that firms met or exceeded analysts' expectations in approximately 65 percent of the firm-quarters in the sample. Only a small portion of the firm-quarters in the sample (4.9 percent) is from firms with a consistent history of prior losses. In addition, the sample firms are relatively large (mean market value of equity of 2.18 billion Chinese Yuan) with a percent of institutional ownership (43.1 percent).

**Table 2: Descriptive Statistics for Dependent Variable, Proxies for Incentives to Avoid Negative Earnings Surprises, and Control Variables**

<u>Variables</u>	<u>n</u>	<u>Mean</u>	<u>Standard Deviation</u>	<u>1st Quartile</u>	<u>Median</u>	<u>3rd Quartile</u>
Dependent Variable:						
MEET	10372	0.652	0.457	0.000	1.000	1.000
%INST	10372	0.431	0.216	0.293	0.458	0.622
LOSS	10372	0.049	0.027	0.000	0.000	0.000
EARNRE	10372	4.109	2.473	2.000	4.000	6.000
SURP	10372	0.33	0.18	0	0.33	1
LTG	10372	17.507	7.994	12.628	16.235	21.388
Control Variables:						
MV	10372	2,180.635	7,182.002	147.436	398.827	1,403.381
TIME	10372	0.12	0.13	0.05	0.08	0.16
IFEI	10372	0.008	0.015	0.001	0.003	0.011

Table3 presents a correlation matrix of all variables, with Pearson (Spearman) correlations below (above) the diagonal. The correlations between the dependent variable (MEET) and each of the incentive variables, presented in the first column/row, are all statistically significant in the predicted directions: %INST, EARNRET, LTG, and SURP are all positively related to MEET, and LOSS, TIME and IFEI is negatively related to MEET. While the correlations are all statistically significant, the magnitudes of many of the correlations are not particularly large. In addition, since all the control variables are significantly correlated with MEET it is important to control for these factors in tests of the incentive variables. Among the incentive and control variables, many of the correlations are significant and several are above 0.2.

Table 3: Correlation among the variable for incentives to avoid negative earnings surprises

	MEET	%INST	LOSS	EARNRET	LTG	SURP	LOGMV	TIME	IFEI
MEET		0.08**	-0.07**	0.04**	0.06**	0.12**	0.09**	-0.04**	-0.29**
%INST	0.08**		-0.18**	0.07**	-0.12**	0.17**	0.47**	0.07**	-0.18**
LOSS	-0.06**	-0.21**		-0.17**	0.13**	-0.14**	-0.17**	-0.06**	0.19**
EARNRET	0.03**	0.08**	-0.15**		-0.08**	0.16**	-0.01	0.07**	0.03**
LTG	0.04**	-0.15**	0.18**	-0.07**		0.05**	0.27**	0.05**	-0.04**
SURP	0.11**	0.15**	-0.17**	0.13**	0.04**		0.10**	0.01	-0.03**
LOGMV	0.09**	0.43**	-0.14**	-0.02**	-0.28**	0.09**		0.06**	-0.31**
TIME	-0.03**	0.09**	-0.07**	0.05**	0.04**	0.01	0.07**		-0.06**
IFEI	-0.25**	-0.15**	0.21**	0.01	-0.04**	-0.04**	-0.28**	-0.05**	

I perform logit regressions modeling the probability that a firm meets or exceeds analysts' forecasts at the earnings announcement:

$$\text{Prob}(\text{MEET} = 1) = F(\beta_0 + \beta_1 \% \text{INST}_i + \beta_2 \text{LOSS}_i + \beta_3 \text{EARNRET}_i + \beta_4 \text{LTG}_i + \beta_5 \text{SURP}_i + \beta_6 \text{LOGMV}_i + \beta_7 \text{TIME}_i + \beta_8 |\text{FE}_i| + \varepsilon_i)$$

$$\text{where: } F(\beta X) = \frac{e^{\beta X}}{1 + e^{\beta X}}$$

Results of the logit regressions appear in Table 4. The coefficient on %INST is positive and significant ( $p < 0.001$ ), suggesting that firms with higher institutional ownership are more likely to meet or exceed expectations (consistent with H1). Consistent with the conjecture that firms with low value-relevance of earnings have less incentive to avoid negative earnings surprises (H2), firms with consistent prior losses (LOSS) are less likely to meet or exceed expectations, and firms which earnings are more value-relevant (EARNRET) are more likely to do so. The significantly positive coefficient on LTG in Model supports H3, firms with relatively higher long-term growth prospects appear more likely to avoid negative earnings surprises. The coefficient on the percentage of consecutive positive earnings surprises, SURP, is 0.313, significantly positive at the 1% level. This evidence suggests that firms with a long string of positive earnings surprises are more likely to dampen analysts' earnings expectations. Furthermore, size is statistically significant, but the coefficient on TIME is negative and significant, indicating that short horizon forecasts are more likely to be pessimistic.

Finally, the previous analysis models the probability of meeting or exceeding analysts' expectations and therefore combines observations that exactly meet analysts' earnings expectations with those that exceed analysts' expectations. Some firm characteristics may provide incentives to meet analysts' expectations exactly rather than exceed those expectations. For example, exactly meeting expectations may more effective at avoiding shareholder litigation than exceeding expectations. Consequently, I separately model the probability of exactly meeting (vs. not meeting) expectations and the probability of exceeding (vs. not meeting) expectations. The untabulated results suggest that different firm characteristics are associated with exactly meeting (vs. exceeding) expectations. When I model the probability of exactly meeting expectations, LOSS, LTG, and SURP are highly significant, suggesting that firms with a history of prior losses have weaker incentives, and firms with higher growth prospects have greater incentives, to exactly meet expectations. These variables are generally not significant when modeling the probability of exceeding expectations. In contrast, EARNRET are not significant when modeling the probability of exactly meeting expectations, but are highly significant when modeling the probability of exceeding expectations. These results suggest that firms with more value-relevant earnings have greater incentives to exceed expectations (as oppose to meet expectations exactly).

It is possible the differences between exactly meeting vs. exceeding expectations are the result of the different mechanisms used (earnings management vs. forecast guidance) to avoid negative surprises.

Table 4: Logit Analysis of the Probability of Meeting or Exceeding Analysts' Expectations and the Incentives to Avoid Negative Earnings Surprises

$$\text{Prob}(\text{MEET} = 1) = F(\beta_0 + \beta_1 \% \text{INST}_i + \beta_2 \text{LOSS}_i + \beta_3 \text{EARNRET}_i + \beta_4 \text{LTG}_i + \beta_5 \text{SUR}_i + \beta_6 \text{LOGMV}_i + \beta_7 \text{TIME}_i + \beta_8 |\text{FE}_i| + \varepsilon_i)$$

<u>Variables</u>	<u>Predicted Sign</u>	<u>Coefficient</u>	<u>p-value</u>	<u>Marginal Effectd</u>
Intercept		-1.182	0.001	
%INST (H1)	+	0.413	0.001	0.092
LOSS (H2)	-	-0.272	0.001	-0.058
EARNRET (H2)	+	0.018	0.004	0.005
LTG (H3)	+	0.011	0.001	0.002
SURP(H4)	+	0.313	0.01	0.057
LOGMV	+	0.028	0.002	0.006
TIME	-	-0.226	0.002	-0.045
IFEI	-	-26.803	0.001	-5.892
Log Likelihood			-11,643.58	
Chi-square			3,367.12	
p-value			0.001	

## 5. Conclusion

This study investigates recent allegations in the business press that managers avoid reporting negative earnings surprises at the earnings announcement. Although past academic research documents that analysts' forecasts are optimistic on average (i.e., the average surprise is negative), recent business press articles suggest that managers use either their discretion over reported earnings or their ability to guide analysts' forecasts downward to increase the probability of meeting or beating these forecasts at the earnings announcement. I explore a number of firm characteristics that I expect create greater incentives to avoid negative earnings surprises, and examine the relation between these characteristics and the probability of meeting or exceeding analysts' expectations at the earnings announcement.

The results indicate that firms with higher institutional ownership, higher value-relevance of earnings, high-growth prospects, and a long string of non-negative earnings surprises are more likely to take actions to meet or exceed analysts' forecasts at the earnings announcement. These associations exist even after controlling for other factors associated with the probability of meeting or exceeding analysts' earnings expectations, including the firm size, time analyst make the forecast, and the magnitude of the initial forecast error. Overall, our findings are largely consistent with recent studies on expectations management (Bartov et al., 2002; Matsumoto, 2002).

This paper's findings leave unanswered, why analysts do not learn from past experience and change their consensus estimates in such a way that the incidence of meeting or beating the consensus becomes a random. We leave this for future research.



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