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Discussion of “The Effects of Corporate Governance and Product Market Competition on Analysts’ Forecasts: Evidence from the Brazilian Capital Market”

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Abstract

In this discussion of Almeida and Dalmacio (2015), we highlight some theoretical considerations that links analyst forecast properties with two disciplining mechanisms (i.e. product market competition and corporate governance) and also provide some directions for future research especially in the Brazilian context.
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1. Introduction

Almeida and Dalmacio (2015), hereafter AD, empirically examine the association between analysts’ forecast properties, i.e., accuracy and dispersion, and the intensity of product market competition and the quality of corporate governance for firms listed in the Sao Paulo Stock Exchange (Bovespa). They measure the intensity of product market competition using reverse ordered Herfindahl-Hirschman Index (HHI) and measure the

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quality of corporate governance using the Brazilian Corporate Governance Index (BGCI) which comprises four components—disclosure, board composition and functioning, ownership structure, and shareholder rights. They regress analysts' forecast accuracy on HHI, BGCI, and the interaction of HHI and BGCI. They find that analysts' forecast accuracy (dispersion) is (a) negatively (positively) associated with the intensity of product market competition, i.e., HHI; (b) positively (negatively) associated with the quality of corporate governance, i.e., BGCI; and (c) positively (negatively) associated with the interaction of HHI and BCGI. The idea underlying examining the interaction effects is that product market competition as well as corporate governance are disciplining mechanisms for managerial behavior. Giroud and Mueller (2011) examine whether firms in less competitive industries benefit more from good corporate governance than firms operating in more competitive industries. The notion underlying this question is that product market competition and corporate governance are substitutes: or put differently, the demand for good corporate governance occurs only when the product market cannot perform the disciplining role by itself. Giroud and Mueller (2011) find that U.S. firms with poor-quality corporate governance, as measured by the Gompers, Isshii, and Metrick (2003) index, exhibit worse performance only in less competitive industries. In this backdrop, AD's research question is interesting, in as much as they examine whether corporate governance enhances the information environment in less or more competitive industries in a setting where product market competition and institutions are likely to be weak. Their findings suggest that corporate governance enhances the information environment—and does so more in competitive industries.

In this discussion, in Section 2, we provide some theoretical considerations that help link analysts' forecast properties with the two disciplining mechanisms, i.e., product market competition and corporate governance, and in Section 3, we provide some directions for future work.

2. Theoretical considerations

2.1. Analysts' forecast accuracy

The relationship between the intensity of product market competition and analysts' forecast accuracy is likely to depend on the quantity and quality of disclosures—both financial and non-financial. As such, in developing this link, one needs to consider the insights gleaned from voluntary disclosure research. The informativeness perspective of voluntary disclosure postulates that managers disclose value-relevant information. Early signaling models show that managers/firms disclose all value-relevant information to mitigate the adverse selection problem and align the investors' expectations with their own expectations (Ajinkya & Gift, 1984; Grossman, 1981; Grossman & Hart, 1980Milgrom, 1981). Subsequent models impose costs of disclosure and show that generally good news will be disclosed (Dye, 1985; Verrecchia, 1983). However, the litigation risk hypothesis posits that managers have an incentive to disclose bad news (Kasznik & Lev, 1995; Skinner, 1994). In summary, the informativeness perspective postulates that managers have adequate incentives to informative disclosures. In contrast, the opportunism perspective postulates that disclosures are largely shaped by managers' motives. Managers

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