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Management earnings forecasts and other forward-looking statements☆

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ABSTRACT

We identify forward-looking statements (FLS) in firms' disclosures to distinguish between "forecast-like" (quantitative statements about earnings) and "other", or non-forecast-like, FLS. We show that, like earnings forecasts, other FLS generate significant investor and analyst responses. Unlike earnings forecasts, other FLS are issued more frequently when uncertainty is higher. We then show that *earnings-related* FLS are more sensitive to uncertainty than *quantitative* statements, suggesting that managers are more likely to alter the content than the form of FLS when uncertainty is higher. Our study indicates that incorporating other FLS into empirical measures provides a more comprehensive proxy for firms' voluntary disclosures.

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> "*…a key unanswered question is whether firms identified by prior studies…as 'less forthcoming' disclosers are truly silent about their future operations or whether they use disclosure mechanisms that prior research has overlooked.*" (Li, 2013)

1. Introduction

For several decades, management earnings forecasts have been the focus of significant academic interest. Initially, that interest was driven by the concern that forecasts were not credible – so much so that firms were prohibited by the SEC from providing such forecasts in their securities filings.[1] Following substantial evidence that investors do respond to earnings forecasts (e.g., Patell, 1976; Waymire, 1984; Baginski et al., 1994; Hutton et al., 2003; Rogers and Stocken, 2005), that view has changed considerably. In fact, more recent studies have shown that management forecasts provide more information to investors than any other accounting source (Beyer et al., 2010). A common theme among these studies is the focus on quantitative earnings forecasts.

In this paper, we use textual analysis to study forward-looking information disclosed by managers. We examine both the quantitative estimates of future earnings that are typically treated as forecasts in disclosure research, and the set

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[1] See Cholakis (1999) for the history of the SEC's views regarding corporate projections.

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of qualitative and/or non-earnings forward-looking statements often overlooked in disclosure research.[2,3] To distinguish between different types of forward-looking statements, we identify, for each statement, whether the statement is quantitative or non-quantitative and whether it explicitly refers to earnings or not. We refer to forward-looking statements as “forecast-like” if they are both quantitative and refer explicitly to earnings. We refer to all remaining forward-looking statements as “other”, or “non-forecast-like”, forward-looking statements.[4] Isolating the different types of forward-looking statements, and when managers issue those statements, allows us to investigate why managers make the disclosure choices we observe. While several studies have examined certain types of non-earnings forward-looking statements individually (e.g., revenue or cash flow projections), our goal is to study a comprehensive sample of forward-looking statements (both forecast-like and other) to assess how and why forecast-like statements differ from other forward-looking statements in terms of both determinants and consequences.

We address several questions related to the different types of forward-looking statements, starting with the question of whether, like earnings forecasts, other forward-looking statements are consequential in terms of affecting investor and analyst beliefs. We then focus on managers' decisions to issue different types of forward-looking statements. In particular, we build on prior research that finds a negative relation between investor uncertainty and earnings forecast issuance (Waymire, 1985; Field et al., 2005). We extend this research by examining whether managers uniformly issue less forward-looking information when uncertainty is high or whether uncertainty *differentially* influences the decision to disclose forecast-like forward-looking information versus other forward-looking statements. We view this set of questions as important, given that prior research demonstrates that managers may issue different types of forward-looking information in different contexts.[5]

Next, we use observed disclosure choices to infer *why* managers are reluctant to issue quantitative earnings forecasts when uncertainty is high. We know from prior research that managers fear the costs of unattained projections (Waymire, 1985; Graham et al., 2005). Our question is how that fear manifests in the decision to issue (or not issue) different types of forward-looking statements. We focus on the two identifying characteristics of earnings forecasts (they are quantitative and earnings-related) to ask which aspect of earnings forecasts makes those forecasts less desirable when uncertainty is high: Is it because earnings forecasts are earnings-related or because they are quantitative? We view this last question as essentially asking whether managers are more likely to change the content (earnings vs. non-earnings statements) or the form (quantitative vs. non-quantitative) of forward-looking information in the face of uncertainty.

To answer these questions, we analyze forward-looking statements disclosed in quarterly earnings announcements (where earnings forecasts are typically issued) from 2004–2014. We follow Li (2010) and Muslu et al. (2015) in using keyword-based textual analysis to identify forward-looking statements (excluding those statements that are likely to be boilerplate). We then classify forward-looking statements along the two dimensions that have traditionally defined earnings forecasts: whether the statements refer explicitly to earnings (e.g., using such terms as “earnings” or “profits”) and, separately, whether or not the statements are quantitative.[6] We assess the informativeness of other forward-looking statements by measuring their association with earnings announcement stock returns and analysts' revisions. We then draw inferences about managers' disclosure decisions based on how their disclosures change as a function of uncertainty.

Our results indicate that other forward-looking statements are consequential: earnings announcements with a greater proportion of other forward-looking statements experience greater absolute stock returns during the announcement period as well as sharper improvements in the accuracy of analyst earnings estimates. A one standard deviation increase in the amount of other forward-looking statements has approximately the same market effect as a one standard deviation increase in the amount of forecast-like statements. We emphasize two aspects of this result. First, the market effect is robust to controlling for the amount of forecast-like statements; the information in other forward-looking statements is not subsumed by the information in quantitative, earnings-related forward-looking statements. Second, other forward-looking statements are not only consequential when issued in conjunction with a management earnings forecast (as in the sample examined by Hutton et al., 2003); they are also consequential on a stand-alone basis (i.e., when issued without a concurrent management earnings forecast).

In terms of determinants, we find (similar to the results in Waymire, 1985) a strong negative relation between uncertainty and the issuance of forecast-like forward-looking statements. However, we find the opposite for other forward-looking statements. That is, managers issue *more* non-forecast-like forward-looking statements when uncertainty is higher. The increase in other forward-looking statements when uncertainty is higher is consistent with Matsumoto et al. (2011), who study conference calls and note that “the lack of earnings guidance when performance is poor is not due to a lack of

[2] By design, we do not restrict our sample to only those firms that issue quantitative earnings guidance. We examine the disclosure behavior of a broad sample of firms regardless of whether or not they issue the management earnings forecasts traditionally studied in prior disclosure research.

[3] First Call's CIG database, a common source of forecast data in recent years, illustrates the bias towards quantitative earnings forecasts. The database ostensibly includes both qualitative and quantitative management earnings forecasts. However, fewer than 5% of post-Regulation FD forecasts in the database are qualitative.

[4] Note that “forecast-like” statements will generally include the quantitative earnings forecasts typically studied in prior literature. We use the term “forecast-like statement” to refer to quantitative earnings statements that we identify via textual analysis, and “earnings forecasts” to refer to quantitative earnings statements identified via the I/B/E/S guidance database. Section 3.2 discusses the classification process in greater detail.

[5] This research generally studies targeted samples of firms (such as Kasznik and Lev, 1995, who study firms with extreme earnings changes) and/or subsets of forward-looking disclosures (such as Wasley and Wu, 2006, who study cash flow forecasts, or Lu and Tucker, 2012, who study capital expenditure and strategic plan disclosure). We discuss this research in Section 2.

[6] We perform extensive validation tests of our text-based classification, and discuss those tests in Section 3.4 and in our Online Appendix.

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