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Do conference calls facilitate market price discovery? Evidence from Taiwan☆

Shou-Min Tsao[a], Hsueh-Tien Lu[b,*], Edmund C. Keung[c]

[a] Department of Business Administration, National Central University, Taoyuan, Taiwan
[b] Department of Accounting, Chinese Culture University, Taipei, Taiwan
[c] Department of Accounting, National University of Singapore, Singapore

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ABSTRACT

This study examines whether conference calls accelerate the speed at which the market and analysts understand the implications of the accrual components of current earnings on future earnings. We analyze Taiwan's listed firms from 2001 through 2014 and find that (1) delayed market reactions to earnings news during the following 12 months occur less often for firms than for host conference calls, and (2) conference calls are associated with a significant improvement in the accuracy of analysts' earnings forecasts. One possible explanation for our results is that conference calls improve the efficacy of investors' and analysts' reactions to earnings announcements by conveying information regarding the accrual components of reported earnings. Our results have implications for other Asian economies that have relatively opaque information environments and weak shareholder protections.

1. Introduction

This study examines whether conference calls improve the efficacy of market reactions and analysts' responses to earnings announcements. We analyze Taiwan's listed firms from 2001 through 2014 and examine how conference calls affect delayed market reactions to earnings announcements and analysts' forecast errors and dispersions. Conference calls have become an increasingly common and important channel that senior management uses to convey a large amount of information to financial analysts and institutional investors (Frankel et al., 1999; Bowen et al., 2002; Bushee et al., 2003; Brown et al., 2004; Kimbrough, 2005). The association between conference calls and the speed at which information from currently reported earnings is incorporated into market prices and analysts' earnings forecasts is a matter of interest and importance.

Kimbrough (2005) examines whether conference calls accelerate analysts' and investors' responses to the future implications of recently announced earnings in the United States. However, because important differences exist in the institutional settings of countries and they may not be obvious a priori, the results of Kimbrough's study may not generalize to other economies. For example, Bassemir et al. (2013) and other studies argue that the effects of firm disclosures on analysts' forecasts generally depend on the institutional framework. Therefore, the results from the US or Germany may not generalize to other forecasting environments.

Taiwan provides an interesting setting for examining the role of conference calls for the following reasons. First, Taiwan is often

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* Corresponding author at: Department of Accounting, Chinese Culture University, 55, Hwa-Kang Rd., Yang-Ming-Shan, Taipei City 11114, Taiwan.
E-mail address: lxd3@ulive.pccu.edu.tw (H.-T. Lu).

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considered an insider economy (Leuz et al., 2003).[1] The majority of the firms in Taiwan are family owned and do not have adequate representation of shareholders that are not members of the family.[2] Because family owners control these firms, they also control the firm's accounting information and reporting policies.[3] It is unclear whether these controlling shareholders use conference calls as a credible commitment to higher-quality disclosures.

Second, conference calls are an important vehicle that managers use to convey predictive information to the market. However, in markets where investor protection is weak, such as Taiwan, managers are more likely to behave opportunistically and manipulate earnings and other voluntary disclosures.[4] Therefore, if managers provide misleading disclosures, conference calls may increase information asymmetry.

Third, trading decisions in Taiwan are easily affected by misleading disclosures and market sentiment due to the lack of US-style institutional investors. Barber et al. (2007) note that the average annual stock turnover rate on the Taiwan Stock Exchange Corporation is approximately 300%, which is remarkably higher than the 97% average annual stock turnover rate for the New York Stock Exchange. Individual investors account for approximately 90% of the entire trading volume in Taiwan because stocks are broadly held and constitute an important asset class for many Taiwanese households. Unlike the use of conference calls in the United States, in Taiwan, it is unclear whether conference calls convey useful information or merely consist of "cheap talk" that is intended to drive up share prices.

The analyst industries in Taiwan and the US have many similarities. Financial analysts assist an investment bank's underwriting department with marketing stock offerings and serve institutional clients who provide commission revenues to their brokers. However, the incentives for generating brokerage commissions are more important in Taiwan because of the high annual stock turnover rate on the Taiwan Stock Exchange. According to Moyes et al. (1997), the financial analyst industry in Taiwan is much less mature than in the U.S. Taiwanese financial analysts have the three following characteristics: 1. perform both buy-side and sell-side functions; 2. have lighter coverage of firms; and 3. have limited access to private information disclosures that are made by management relative to analysts in the U.S. Due to the lack of informal disclosures by management, analysts generally resort to other sources for forecast information (e.g., industry data, economy indices, government policy statements, etc.). As a result, beginning in the late-1990s, conference calls that are often held by companies enrich the information set that analysts use to make earnings forecasts (Liang et al., 2012).

Conversely, in terms of ownership, institutional investors are more likely to invest in holdings of business groups.[5] Business groups are an important organizational form that is prevalent in emerging economies (Peng et al., 2005; Yiu et al., 2005). Taiwan is a typical representative of the East Asian business world. The formation of Taiwanese business groups is partially rooted in the traditional Chinese cultural context. Shareholder activism is essentially absent in Taiwan. Prior studies find that the likelihood of holding conference calls is associated with foreign ownership (Liang et al., 2012) and interlocked directors (Chan et al., 2017).[6,7] However, how financial analysts respond to the information needs of these business groups represents an empirical question.

Our evidence is based on a sample of Taiwanese listed firms from 2001 to 2014. Our first set of tests investigates investors' delayed market reactions to earnings announcements for firms that host conference calls and those that do not. We report a delayed market reaction to earnings surprises in Taiwan and note a significant reduction in delayed market reactions for our conference call sample. Furthermore, this reduction in delayed market reactions is stronger for firms with higher accruals. Conference calls appear to increase the speed at which the market incorporates information into stock prices by conveying information regarding the accrual components of reported earnings.

Our second set of tests investigates whether earnings announcement-related conference calls help financial analysts ascertain future financial performance implications of the accrual component of current earnings. Consistent with Bradshaw et al. (2001) and Barth and Hutton (2004), Taiwanese analysts do not fully consider the predictable future earnings declines that are associated with high accruals in reported earnings. We should find a weaker association between accruals and future earnings forecast errors and

[1] Leuz et al. (2003) perform a descriptive country cluster analysis and classify countries that have similar legal and institutional characteristics. These scholars classify Taiwan as an insider economy with less-developed stock markets, concentrated ownership, weak investor rights, and strong legal enforcement.

[2] Taiwan has a two-tiered board structure that includes a board of directors and a board of supervisors. This structure is in direct contrast with the unitary board structure in the United States. However, a two-tiered structure is common in Europe. Dargenidou et al. (2007) report that a two-tiered structure is present in Belgium, Finland, and France, but is dominant in Germany, the Netherlands, and Denmark.

[3] Ali et al. (2007) argue that family firms face less severe agency problems that arise from the separation of ownership and management (Type I agency problems), but face more severe agency problems that arise between controlling and non-controlling shareholders (Type II agency problems). These scholars demonstrate that relative to nonfamily firms, US family firms exhibit higher earnings quality. We argue that Type II agency problems may have a stronger impact on the financial reporting practices in Taiwan (see the following discussion).

[4] Prior studies suggest that investor protection in civil law countries is weaker than in common law countries (La Porta et al., 1998; Ball et al., 2000). For example, Fan and Wong (2002) find that earnings informativeness, which is measured by the earnings–return relationship, is negatively related to the ultimate owner's control level in East Asian countries.

[5] A business group is a collection of legally independent firms that are linked by economic (such as ownership, financial, and commercial) and social ties (such as family, kinship, and friendship) (Yiu et al., 2005). One interesting feature of Taiwanese business groups is that many are family controlled (Luo and Chung, 2005).

[6] Liang et al. (2012) examine the effects of foreign institutional ownership and voluntary disclosure in Taiwan. These scholars report that foreign institutional ownership is positively associated with the probability of holding conference calls.

[7] Listed firms in East Asia, including Taiwan, are typically majority owned and controlled by family businesses. To retain their power, family members must control the majority of seats on the boards of subsidiaries or group companies, which results in interlocked directors (e.g., Yeh et al., 2001; Liu and Yang, 2008). Chan et al. (2017) demonstrate that firms that are connected to conference-call-making firms through interlocked directors are more likely to hold conference calls. Interlocking directors expand the practice of holding conference calls because of the expected benefits of reducing information asymmetry between management and outside investors.