

THE OVERLAP BETWEEN MANAGEMENT EARNINGS FORECASTS AND PRIOR ANALYST EARNINGS FORECASTS

BASIC RESEARCH QUESTION

What are the determinants of the overlap?

KEY PAPER(S)

Ciconte, W., Kirk, M., & Tucker, J. W. (2014). Does the midpoint of range earnings forecasts represent managers' expectations? *Review of Accounting Studies*, 19(2), 628-660.

Tang, M. M., Zarowin, P., & Zhang, L. (2015). How do analysts interpret management range forecasts? *Accounting, Organizations and Society*, 42, 48-66.

Tang, M. M., & Zhang, L. (2016). Range Has it: Decoding the Information Content of Forecast Ranges. *Working paper*, New York University and Rutgers University.

MOTIVATION/ PUZZLE

Prior studies find that managers tend to issue management earnings forecasts (i.e. MEFs) in a range format instead of a point format that was the dominant format earlier (e.g., Ciconte et al., 2014). However, few explanations on such format changes are provided. A recent working paper, Tang & Zhang (2016), further observes a phenomenon that 84% of all range MEFs are overlap with the range formed by prior analyst forecasts (i.e. AEFs) but fail to examine the ex-ante reasons of an overlap. I expect that managers choose a range format for the benefits of an overlap. This also answers Tang et al. (2015)'s call for future research on the interaction between the range of MEFs and the range of AEFs.

THREE CORE ASPECTS OF ANY EMPIRICAL RESEARCH PROJECT

THE IDEA

This study expects that some extent of overlap MEFs can help managers to reduce information costs (i.e. the effort and time on collecting and analysing information), consequential costs (i.e. proprietary costs for good news MEFs and negative market reactions to bad news MEFs), and maintain a cordial relationship with analysts. First, given that analysts generate AEFs from a wide range of information including costly macroeconomic and competitors' information, managers may strategically enlarge the extent of an overlap for gaining analysts' information easily, especially for firms with weaker internal control or managers with lower forecast abilities. Second, given that an overlap range alone means no news, managers in firms with higher competitions (litigation risks) may tend to issue larger extent of an overlap to reduce proprietary costs (negative market reactions). Third, by signaling managers' endorsement for analysts' prior works, a larger overlap MEF can help managers to maintain a cordial relationship, which is more necessary for firms with lower analyst coverage.

THE DATA

1. The sample consists of all annual range MEFs and prior range AEFs in all listed U.S. firms across a 20-year period from 1996 to 2015. Before 1996, the percentage of MEFs issuance is less than 2%.
2. The expected total sample size is 15,000 observations, which is similar with Tang & Zhang (2016).
3. All data can be collected from databases provided by UQBS.
4. There will be some problems with missing data, given the relatively large time frame.
5. The data should be reliable because they are from the popular databases.
6. There might be some external validity issues because only firms with both MEFs range and AEFs range are kept for examinations.

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THE TOOLS

This study will use a two-stage regression model. First, the extent of an overlap is regressed by information asymmetry, the width of MEFs range, the width of AEFs range, and other control variables. The residual value in the first model captures the unexpected (i.e. strategic) component of the overlap which will then be regressed by my variable of interests (i.e. underlined variables in Part E) and control variables.

TWO KEY QUESTIONS

WHAT'S NEW

This study is novel in examining the comparison between the range of MEFs and the range of AEFs, while most prior studies tend to use midpoints of the ranges, which may neglect some information content in the whole ranges. This results in my analysis of an overlap, the extent of which might be influenced by management strategic incentives, in addition to a natural coincidence. These incentives innovatively build upon the existing literature in MEFs, behavior finance, and even psychological studies.

SO WHAT

First, this study has implications for investors and analysts who always observe an overlap MEF. It addresses their common beliefs that the extent of an overlap increases with the degree of shared information between managers and analysts. This study extends their beliefs by showing the management strategically use of an overlap in order to reduce information costs, consequential costs, and maintain a cordial relationship with analysts. Second, this study has implications for researchers on further investigating the stakeholders' reactions to the extent of an overlap.

ONE BOTTOM LINE

THE CONTRIBUTION

Four contributions to the existing literature in MEFs:

1. It fills in the lack of explanations on why managers tend to issue range MEFs (almost 80%) instead of point MEFs (nearly 20%) recently, and over 85% of range MEFs are overlap MEFs, using the evidence of management strategic incentives in issuing an overlap MEF.
2. It might be the first study arguing that managers may rely on analysts in generating MEFs, rather than purely analysts relying on managers for information.
3. It extends studies on why managers still privately communicate their inside information to analysts even if this is prohibited by Reg FD, with the evidence of management incentives to maintain a cordial relationship with analysts.
4. It supports the current criticisms of MEFs by providing the evidence of the management strategic uses of an overlap.

OTHER CONSIDERATIONS

- Collaboration may not be needed.
- My target journals may be ambitiously set at A* accounting journals.
- There might be some "competitor" risk because this study may need almost half a year to become a working paper, while many experienced researchers may come up with a similar idea.
- The most important challenge is to build strong arguments for my proposed management incentives. The other challenge is about the purchase of MEFs data, the cost of which may exceed my PhD fund.
- The scope seems appropriate.