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THE INCIDENCE OF EXPECTATIONS MANAGEMENT IN THE POST-REGULATION FAIR DISCLOSURE PERIOD

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ABSTRACT

This paper investigates the incidence of expectations management in the post-Regulation Fair Disclosure period. Using uniquely hand-collected data, I present direct evidence that the expectations management game is still played in the new regulatory environment. Management has switched to issuing pessimistic public guidance (instead of relying on private communications as in the pre-Regulation Fair Disclosure period) to dampen analysts' expectations to a beatable level. In addition, they use both quantitative and qualitative, both earnings-related and nonearnings-related disclosures to influence analysts' forecasts. However, I find that expectations management is decreasing during my sample period (2001-2004).

INTRODUCTION

The phenomenon that managers guide analysts' earnings expectations to avoid negative earnings surprises has received considerable attention from both the popular press and accounting regulators over the past number of years. For example, a May 6th, 1991 Wall Street Journal article states, "these days, many companies are encouraging analysts to deflate earnings projections to artificially low levels, …If the game is played right, a company's stock will rise sharply on the day it announces its earnings -- and beats the analysts' too-conservative estimates..." (Cohen, 1991). In a widely cited speech made on September 28, 1998, Arthur Levitt, Chairman of the Securities and Exchange Commission at that time, expressed concern about the "expectations management game." He noted, " Increasingly, I have become concerned that the motivation to meet Wall Street earnings expectations may be overriding common sense business practices. Too many corporate managers, auditors, and analysts are participants in a game of nods and winks. In the zeal to satisfy consensus earnings estimates and project a smooth earnings path, wishful thinking may be winning the day over faithful representation. As a result, I fear that we are witnessing an erosion in the quality of earnings, and therefore, the quality of financial reporting. …" (Levitt, 1998).

Accounting researchers have also shown evidence consistent with firms engaging in expectations management to meet or beat financial analysts' forecasts. Several studies find that firms deliberately guide analysts' forecasts downward to avoid a "disappointment" at the official earnings announcement date (e.g. Matsumoto, 2002, Bartov et al., 2002, Richardson et al., 2004, Li et al., 2014, Li, 2019). Furthermore, Bartov et al. (2002) and Brown and Caylor (2005) report that expectations management has increased substantially in recent years.

Motivated by the concerns expressed by the popular press, accounting regulators and accounting researchers, this paper examines the incidence of expectations management in the post-Regulation Fair Disclosure (FD, hereafter) period. Regulation FD was implemented by the U.S. Securities and Exchange Commission in 2000 to address concerns regarding selective disclosure of material information by publicly traded companies. Prior to the introduction of Regulation FD, companies could share important information with a select group of analysts and investors, giving them an unfair advantage over the public. A survey conducted by the National Investor Relations Institute (NIRI) in 2001 on the effects of Regulation FD shows that many companies worked closely with analysts in developing their earnings forecasts prior to Regulation FD. 81% of the firms claimed that the managers or someone from the firm reviewed the analysts' earnings models in the pre-Regulation FD period. Regulation FD aimed to level the playing field by mandating that companies disclose material information to all market participants simultaneously.

Most of the current expectations management literature focuses on the pre-Regulation FD period (e.g. Matsumoto, 2002, Bartov et al., 2002, Richardson et al., 2004, Brown and Caylor, 2005), and mainly used the downward forecast revision as the proxy for expectation management. However, in the post-Regulation FD period, management's private earnings guidance was prohibited. If they still intend to influence analysts' forecasts, they must switch to public guidance, making it possible to directly observe and measure expectations management activities.

I begin my analysis by selecting a group of firms that are *suspected* to have successfully beaten analysts' forecasts through expectations management. Prior research has shown that on average, analysts' forecasts are systematically optimistic at the beginning of the fiscal period, and then become systematically pessimistic at the end of the fiscal period (Bartov et al., 2002, Richardson et al., 2004, etc.). In these studies, a downward analyst forecast revision is interpreted as evidence of management's intervention to bring analysts' forecasts down to a meetable/beatable level. Following the methodology of prior research, I obtain a sample of 1,073 firm-quarters between 2001 and 2004 where analysts' downward revisions turn a negative forecast error into a positive earnings surprise, and then I investigate all the public managerial disclosures (both quantitative and qualitative, both earnings-related and nonearnings-related) made by these firms in a short period before the actual earnings announcement to ascertain whether indeed management issued guidance that could have influenced analysts' forecasts.

I find that 58.4 percent of such firm-quarters issued pessimistic public guidance while 40.4 percent of the firm-quarters didn't issue any public disclosures during the window examined. The remaining 1.2 percent issued either optimistic or neutral public guidance. The implications of the evidence are twofold. First, this result shows that the expectations management game is still played, and is played in a public way after the enactment of Regulation FD. Second, this result suggests that the use of the downward analyst forecast revision as a proxy for expectations management might misclassify a significant portion of firms that do not guide (silent firms) as firms that guide in the post-Regulation FD period. Moreover, I find that expectations management is decreasing during my sample period. This is somewhat contrary to previous studies (mainly focused on the pre-Regulation FD era) which find expectations management is becoming more common over time (Matsumoto, 2002, Brown and Caylor, 2005). This result is supported by a recent study, Koh et al. (2008), which examines meeting or beating analyst expectations in the post-scandals/Sarbanes-Oxley Act period. Although Regulation FD is not their primary variable of interest, their Table 5 Panel B presents evidence consistent with firms relying on expectations management to meet or beat analyst forecast have decreased after Regulation FD. A possible explanation is that firms that relied on the private earnings guidance in the pre-Regulation FD period found it difficult to switch to public guidance in the post-Regulation FD period, and therefore, reduced their earnings guidance activities.

This study contributes to the literature in that it provides *direct* evidence of expectations management in the post-Regulation FD era by directly investigating the public communications between the management and the analysts, extending the prior research based on downward revisions of analyst forecast (Bartov et

al., 2002, Richardson et al., 2004, etc.). In this regard, this paper is related to Cotter et al. (2006) and Baik and Jiang (2005), which have documented that management forecasts play an important role in leading analysts toward beatable earnings targets. However, both papers focus only on quantitative management earnings forecasts issued for quarterly earnings per share. Prior research finds that fewer than 25 percent of management disclosures are point or range estimates (Pownall et al., 1993, Baginski et al., 1990). Focusing on only quantitative earnings guidance may overlook useful information contained in qualitative guidance and in non-earnings related guidance. This study examines a much broader definition of public guidance, and the results show that a significant portion of firm-quarters issued qualitative earnings disclosures and non-earnings related (sales, operating expenses, etc.) disclosures to guide analysts' expectations.

The remainder of the paper is organized as follows: I review the related literature in the next section, followed by the sample selection and data collection procedures. In the results section, I conduct empirical analyses and present the results. In the last section, I conclude and discuss possible future research questions.

LITERATURE REVIEW

There is abundant academic evidence in the accounting literature suggesting that firms use both accrual-based earnings management and expectations management to meet or beat financial analysts' expectations (MBE, hereafter). For example, Burgstahler and Eames (2003) find that the time-series behavior of earnings is consistent with companies managing their earnings to MBE. Payne and Robb (2000) find that firms with pre-managed earnings below analysts' expectations have greater positive abnormal accruals. Kaznik and McNichols (2002) also provide evidence consistent with earnings management to meet or beat forecasts. In addition to earnings management, Matsumoto (2002) and Bartov et al. (2002) provide evidence consistent with expectations management as a means to MBE.

This paper focuses on expectations management. Managing earnings is risky because auditors scrutinize questionable accounting practices, and managers cannot manage earnings continually due to the reversal property of accruals. By contrast, expectations management is not subject to audit and has no direct impact on reported earnings. Therefore, expectations management appears to be a "safer" venue to help firms MBE.

The current academic evidence on expectations management is largely indirect. Bartov et al. (2002) document that the proportion of cases where analyst downward revision turns a negative forecast error into a positive or zero earnings surprise is significantly greater than the proportion where analyst upward revision turns a positive or zero forecast error into a negative earnings surprise. Brown and Caylor (2005) find a significant temporal trend in the pattern documented in Bartov et al. (2002), consistent with expectations management being more popular over their sample period. Richardson et al. (2004) show that analysts systematically revise their initially optimistic forecasts down to beatable level just prior to the actual earnings announcement. Matsumoto (2002) uses a different approach. She develops a model to measure the unexpected portion of the analyst forecast (UEF) and finds that the mean of UEF is negative, indicating that on average, analyst forecast is lower than what it should be (as predicted by her model). These findings have been interpreted at the *prima facie* evidence on expectations management.

However, without direct examination of management's actual communication with analysts, it is not clear whether the downward revision or the unexpected analyst forecast is driven by management's intervention. For example, other factors may explain why analysts revise their forecasts downward. As the earnings announcement date approaches, more information becomes available to analysts. Analysts become more efficient and the overly optimistic forecasts at the beginning of the period get corrected gradually (Elton et al., 1984).

This paper extends the extant expectations management literature by investigating management's public discretionary disclosure as a mechanism to guide analysts' estimates downward to a beatable level in the post-Regulation FD period. Both academic and anecdotal evidence suggest that managers have the ability to influence analysts' forecasts through discretionary disclosure. "…as a key provider of information to analysts, managers can affect analysts' earnings expectations by controlling the content and timing of discretionary information releases" (Richardson et al., 2004). The passage of Regulation FD prevents firms from disclosing information to selected parties, and therefore prohibits private conversations between the management and the analysts. This makes public discretionary disclosure an appealing tool to dampen analysts' expectations in the new regulatory environment. In this paper, I provide evidence on the actual use of public managerial disclosure to lower analysts' expectations in the post-regulation FD era.

SAMPLE SELECTION AND DATA SOURCE

I begin by selecting a sample of firms that are more likely to have beaten analysts' forecasts through expectations management. The analyst forecasts-related data were retrieved from the 2005 Institutional Brokers' Estimate System (I/B/E/S) Summary History File. I/B/E/S is a database maintained by Thomson Reuters which provides analyst earnings estimates and firm guidance for most publicly traded companies. It is widely used by brokers, investors, and business researchers for accessing analysts-related data. Firm-quarters that meet the following criteria are selected: (1) the last available I/B/E/S analysts' median consensus forecast (denoted as F_L) before the actual earnings announcement is lower than the actual earnings; (2) the last available I/B/E/S analysts' median consensus forecast (denoted as F_P) prior to F_L is higher than the actual earnings).

I choose consensus forecast instead of individual forecast (e.g. Bartov et al., 2002) because managers are more likely concerned with whether the actual earnings can meet or beat the consensus forecast (as reported in company press releases), rather than any individual forecast. This should be especially true in the post-Regulation FD period, as managers can no longer privately communicate to selected individual analysts to influence their forecasts and any public disclosures should be targeted to influence all the analysts (the consensus forecast). I choose the median consensus forecast instead of mean consensus forecast to mitigate the influence of extreme individual forecasts. Stale forecasts that have not been updated since the previous quarter's earnings announcement are excluded from the consensus forecast computation. I denote this sample as the *Down-Beat* sample.

Figure 1 presents the timeline of events. F_L is about 30 days after F_P because I/B/E/S publishes consensus forecasts on the third Thursday every month. The median number of days between F_L date and the subsequent earnings announcement is 11 days.
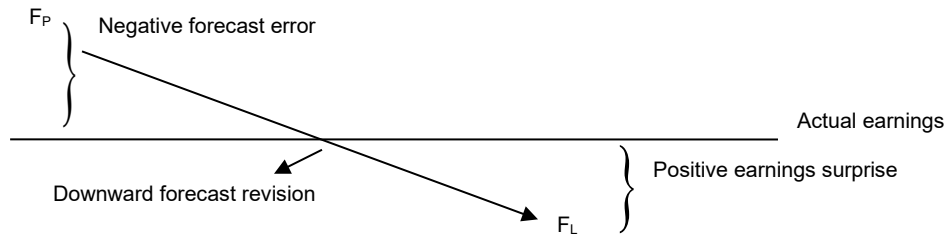
Figure 1: Timeline of Events

Figure 1 shows the timeline of events. F_L is the last available analysts' consensus earnings forecast before the actual earnings announcement; F_P is the last available analysts' consensus earnings forecast prior to F_L; Q_t denotes the previous quarter end and Q_{t+1} denotes the current quarter end. F_L is about 30 days after F_P.

I then select another sample of firms that are *less likely* affected by expectations management as a control group. Specifically, I select firm-quarters where (1) F_L is optimistic (relative to the actual earnings), and (2) F_P is pessimistic (relative to the actual earnings). I denote this sample as the *Up-Miss* sample.

Figure 2 shows the sample selection criteria for the *Down-Beat* sample and the *Up-Miss* sample. The *Down-Beat* sample includes firm-quarters where analysts revised their optimistic initial forecast (F_P) downward, and this downward revision successfully turned a negative forecast error (measured as the actual earnings minus F_P) into a positive earnings surprise (measured as the actual earnings minus F_L) prior to the earnings announcement. The *Up-Miss* sample consists of firm-quarters where analysts revised their pessimistic initial forecast (F_P) upward, and this upward revision led to missing the analysts' expectations at the earnings announcement date.

Figure 2: Sample Selection Criteria: Down-Beat Sample Vs. Up-Miss Sample

Down-Beat Sample: firm-quarters that are *more likely* affected by expectations management (the analysts revised the initially optimistic forecast downward to a beatable level)

Up-Miss Sample: firm-quarters that are *less likely* affected by expectations management (the analysts revised the initially pessimistic forecast upward, and the firm-quarters missed the analysts' expectations at the earnings announcement)
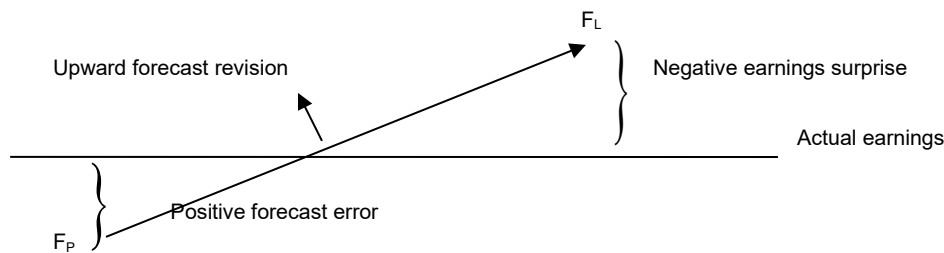

Figure 2 presents the sample selection criteria for the Down-Beat sample and the Up-Miss sample. F_L is the last available analyst consensus earnings forecast before the actual earnings announcement; F_P is the last available analyst consensus earnings forecast prior to F_L; Forecast error is measured as the actual earnings minus F_P; Earnings surprise is measured as the actual earnings minus F_L.

I hand-collected all the public disclosures (both quantitative and qualitative) with implications for quarterly earnings issued between F_P and F_L by the management of the firm-quarters in the two samples. In the expectations management game, timing is a crucial factor. Accordingly, I exclude statements made by management at the beginning of the quarter, because at that time management has a high level of uncertainty about what the actual earnings would be. Therefore, such disclosures are more likely to be issued to correct the analysts' optimism and less likely for expectations management purpose. Many prior studies on the use of managerial disclosures to influence the analysts' and investors' perceptions of earnings also focus on a short disclosure window. For example, Kasznik and Lev (1995) examine disclosures made within 60 days

before the actual earnings announcements for firms with large earnings surprises. Soffer et al. (2000) investigate earnings preannouncements made from two weeks before the end of the quarter until the day before the earnings announcement date. In addition, Tse and Tucker (2010) point out that negative earnings disclosures come in two waves. The beginning-of-quarter ones tend to be genuine management forecast while the end-of-quarter ones tend to be earnings warnings/guidance.

The public disclosures (company press releases, verbal transcripts of conference calls, analyst meetings, etc.) are obtained from the Lexis/Nexis News Wires File, the StreetEvents database, company website and other sources. The StreetEvents is a database maintained by Thomson Financial, which provides corporate disclosure and brokerage event information for more than 6,500 public companies. I used multiple channels to collect managerial disclosures to ensure the completeness of my dataset.

I then classify each firm's disclosures into seven disclosure types: (1) Point forecasts of earnings, (2) Range forecasts of earnings, (3) Qualitative disclosures about earnings, (4) Point forecasts of sales, (5) Range forecasts of sales, (6) Qualitative disclosures about sales, and (7) Other operating information, such as announcements of components of earnings, changes in operating expenses, etc. The first three are all earnings-related disclosures and the last four are nonearnings-related disclosures.

I consider sales-related information and other operating information because nonearnings-related disclosures provide indirect or partial information about earnings (Kasznik and Lev, 1995). I investigate qualitative statements such as "earnings will fall below expectations" because they also convey earnings information to analysts and investors (Skinner, 1994).

I excluded firms in regulated industries as they are likely to have different incentives to MBE than those in non-regulated industries (Matsumoto, 2002). Specifically, I exclude financial institutions (SIC codes 6000-6999), utilities (SIC codes 4800-4999), and other quasi-regulated industries (SIC codes 4000-4499, and 8000 and higher).

The sample period is restricted to years after Regulation FD was formally enacted, specifically, from January 2001 to December 2004. The *Down-Beat* sample is composed of 955 firms with 1,073 firm-quarter observations with required data available, while the *Up-Miss* sample is composed of 98 firms with 107 firm-quarter observations with required data available.

RESULTS

To provide direct evidence of management's involvement in the expectations guidance game in the post-Regulation FD period, I read all the disclosures made between F_P and F_L by the *Down-Beat* and the *Up-Miss* sample firm-quarters. I classify disclosures as pessimistic/neutral/optimistic guidance if they indicate that earnings will be worse/the same/better. Specifically, for quantitative earnings disclosure, I compare the exact value of the point forecast and the mid-point of the range forecast to the initial analyst consensus forecast (F_P). Additional analysis shows that approximately 92% of the pessimistic quantitative earnings forecasts are not only lower than the initial analyst consensus forecast, but also lower than the actual earnings reported.

Forecasts that fall below/equal/exceed the initial analyst consensus forecast are classified as pessimistic/neutral/optimistic guidance. Nine *Down-Beat* firm-quarters made open-ended ("more than" or "less than") earnings forecasts. I compare the end value of the forecast with the initial analyst consensus forecast for guidance classification. None of the *Up-Beat* firm-quarters made open-ended earnings disclosures. For quantitative sales disclosures, I use management's or analysts' previous sales forecast, whichever is available, as the benchmark for the classification. For qualitative disclosures, statements such as "earnings will not meet (will beat) the existing analyst consensus forecast" are classified as pessimistic (optimistic) guidance and statements such as "earnings will be consistent with the existing analyst consensus

forecast " are classified as neutral guidance. Another researcher independently classified a select number of my sample observations. The Cronbach's alpha test ($\alpha > 0.95$) indicates that the coding of the disclosures is reliable.

The majority of the *Down-Beat* sample firms made only one disclosure during the interval examined for a specific quarter. Managers may issue last-minute guidance right before the actual earnings announcement date. Therefore, I also investigated all the managerial disclosures made in the period between F_L and the actual earnings announcement. I find that 11 *Down-Beat* sample firm-quarters made disclosures during this period, and all the 11 disclosures confirmed the previous disclosures made between F_P and F_L. No *Up-Miss* sample firm-quarters made disclosures between F_L and the actual earnings announcement. It seems that the F_P-to- F_L window successfully captures the majority of the earnings guidance activities.

Less than three percent of the firms provided multiple disclosures. For these firms, I consider the most current disclosure for guidance classification. I only consider the most current disclosure because half of the multiple disclosure firms issued subsequent disclosure to correct the information contained in the previous disclosure, while the other half made subsequent disclosure to confirm or reinforce the information contained in the previous disclosure. The latest disclosure tends to represent the final message that managers want to convey to the market participants. None of the *Up-Miss* sample firms issued more than one disclosure during the window examined.

If management simply issues pessimistic guidance when the initial analyst consensus forecast is too high and issues optimistic guidance when the initial analyst consensus forecast is too low, the proportion of pessimistic guidance made by the *Down-Beat* sample firm-quarters should be the same as the proportion of optimistic guidance made by the *Up-Miss* sample firm-quarters. However, if managers deliberately issue pessimistic guidance to bring an optimistic analyst forecast down to a beatable level, the proportion of pessimistic guidance made by the *Down-Beat* sample firm-quarters should be greater than the proportion of optimistic guidance made by the *Up-Miss* sample firm-quarters.

Table 1 shows that management's disclosure policy is asymmetric in the two samples. 58.4 percent (627 firm-quarters) of the *Down-Beat* sample issued pessimistic guidance, while only 17.8 percent (19 firm-quarters) of the *Up-Miss* sample issued optimistic guidance. The difference in the percentages (58.4 percent-17.8 percent = 40.6 percent) is highly significant ($p < .0001$) (not reported in Table 1). The results are consistent with management's use of pessimistic public guidance to dampen analysts' forecasts in order to achieve a positive earnings surprise, and provide direct evidence of expectations management in the post-Regulation FD period.

Table 1 also shows that a large portion of firm-quarters did not issue any disclosures during the window examined. In the *Down-Beat* sample, 40.4 percent of the firm-quarters kept silent, while in the *Up-Miss* sample, 76.6 percent of the firm-quarters kept silent. Analysts revised forecasts downward or upward right before the earnings announcement date due to factors other than management's intervention. Therefore, the use of downward forecast revision as a proxy for expectations management may misclassify silent firms as guidance firms, and may lead to over-estimating the prevalence of expectations management in the post-Regulation FD environment.

Table 1: Type of Management's Public Guidance

	Down-Beat Sample (Firm-Quarters *Likely* to Be Affected by Expectations Management)		Up-Miss sample (Firm-Quarters *Less Likely* to Be Affected by Expectations Management)	
	N	Percent	N	Percent
Optimistic guidance	7	0.7	19	17.8
Neutral guidance	5	0.5	0	0
Pessimistic guidance	627	58.4	6	5.6
No disclosures	434	40.4	82	76.6
Total	1073	100	107	100

Table 1 reports the type of management's public guidance for the Down-Beat and the Up-Miss samples. The Down-Beat sample includes 1,073 firm-quarters where analyst downward revision turns a negative forecast error into a positive earnings surprise. The Up-Miss sample includes 107 firm-quarters where analyst upward revision turns a positive forecast error into a negative earnings surprise.

Table 2 presents the relative frequency of types of guidance for *Down-Beat* firm-quarters with pessimistic guidance (627 firm-quarters) and *Up-Miss* firm-quarters with optimistic guidance (19 firm-quarters). It is evident that the *Down-Beat* cases used both earnings and nonearnings-related disclosures, and both quantitative and qualitative disclosures to influence the analysts' expectations. In addition, a large portion of the *Down-Beat* cases tend to use more than one guidance type at the same time.

Table 2: Relative Frequency of the Guidance Type

Type of Guidance	*Down-Beat* Cases with Pessimistic Guidance		*Up-Miss* Cases with Optimistic Guidance	
	N	Percent	N	Percent
Range forecasts of earnings, together with point or range estimates of sales	244	38.9	0	0
Qualitative disclosures about earnings and/or sales	70	11.2	2	10.5
Range forecasts of earnings, together with qualitative disclosures about sales	69	11.0	0	0
Range forecasts of earnings only	68	10.8	10	52.6
Range forecasts of earnings, together with disclosures about other operating information	37	5.9	0	0
Point or range estimates of sales only	37	5.9	1	5.3
Point forecasts of earnings, together with point or range estimates of sales	31	4.9	0	0
Point forecasts of earnings only	19	3.0	5	26.3
Other	52	8.4	1	5.3
Total	627	100	19	100

Table 2 documents the relative frequency of types of guidance for Down-Beat cases with pessimistic guidance and Up-Miss cases with optimistic guidance. Down-Beat cases with pessimistic guidance refers to the 627 firm-quarters with downward analyst forecast revision and pessimistic guidance during the window examined. Up-Miss cases with optimistic guidance refers to the 19 firm-quarters with upward analyst forecast revision and optimistic guidance during the window examined.

The largest single group is the range forecasts of earnings, together with point or range estimates of sales (244 firm-quarters or 38.9 percent), followed by qualitative disclosures about earnings and/or sales (70 firm-quarters or 11.2 percent). The third largest single group is the range forecasts of earnings, together with the qualitative disclosures about sales (69 firm-quarters or 11.0 percent). 68 firm-quarters (10.8 percent) issued range forecasts of earnings only. 37 firm-quarters (5.9 percent) issued range forecasts of earnings and disclosures about other operating information, while another 37 (5.9 percent) firm-quarters issued point or range estimates of sales only. In addition, 31 firm-quarters (4.9 percent) issued point forecasts of earnings, together with point or range estimates of sales. 19 firm-quarters (3.0 percent) issued point forecasts of earnings only. 52 firm-quarters (8.4 percent) used other guidance strategies, such as point forecasts of earnings and qualitative disclosures about other operating information.

The majority of the *Up-Miss* cases issued only a single type of disclosure, instead of a combination of multiple disclosure types. For example, ten out of a total of 19 firm-quarters (52.6 percent) issued range forecasts of earnings only, while five out of 19 firm-quarters (26.3 percent) issued point forecasts of earnings only.

From this section on, I denote the 627 *Down-Beat* cases with pessimistic guidance as the *Guidance-Beat* sample, which represents firm-quarters that beat the analysts' forecasts through management's public guidance.

Table 3 presents the descriptive information on the *Guidance-Beat* sample. Panel A reports the year and quarter distribution. There were 230 firm-quarters (36.7%) providing pessimistic guidance to avoid negative earnings surprises in 2001, 154 firm-quarters (24.6%) in 2002, 129 firm-quarters (20.6%) in 2003 and 114 firm-quarters (18.2%) in 2004. The results indicate that expectations management seems to have decreased over my sample period.

Table 3: Descriptive Information on the Guidance-Beat Sample

Panel A: Quarter Distribution	Number of Firm-Quarters N=627 (All years)	Percentage 100%
2001 Q1	54	8.6%
Q2	82	13.1%
Q3	71	11.3%
Q4	23	3.7%
2001 Total	230	36.7%
2002 Q1	30	4.8%
Q2	41	6.5%
Q3	46	7.3%
Q4	37	5.9%
2002 Total	154	24.6%
2003 Q1	46	7.3%
Q2	39	6.2%
Q3	28	4.5%
Q4	16	2.6%
2003 Total	129	20.6%
2004 Q1	15	2.4%
Q2	29	4.6%
Q3	44	7.0%
Q4	26	4.1%
2004 Total	114	18.2%

Panel B: Temporal Analysis of Frequency of Guidance

Model 1: $Freq_t = \gamma_0 + \gamma_1 TimeTrend_t + \varepsilon_t$

	Coefficient Estimate	p-value
Intercept	59.475	<.0001***
TimeTrend	-2.387	0.011**
Adj. R^2	33.87%	

Panel C: Timing of the Guidance

Variable	Mean	Standard Deviation	1st Quartile	Median	3rd Quartile
Days_Guidance_Qend	-1	10.80	-9	1	7
Days_Guidance_EA	28	9.38	14	25	35

*Table 3 is based on the 627 Down-Beat firm-quarters (denoted as the Guidance-Beat sample) that issued pessimistic guidance during the window examined. Panel A shows the year and quarter distribution. Panel B reports the regression results of the temporal analysis of guidance frequency. Panel C presents the timing of the guidance. Days_Guidance_Qend denotes the number of days between the guidance date and the current quarter end. Days_Guidance_EA denotes the number of days between the guidance date and the actual earnings announcement date. *** and ** denote significance at 1% and 5% levels, respectively.*

This is somewhat contrary to the previous studies that find expectations management is increasing over time (e.g., Brown and Caylor, 2005). This may be due to the different sample periods considered. I focus on the post-Regulation FD period while previous studies mainly focus on the pre-Regulation FD period. Regulation FD prevents informal, private conversations between management and analysts. Firms that relied on private guidance to achieve positive earnings surprises may find it difficult to do so in the new regulatory environment, and therefore reduced their expectations management activities.

To statistically test the decreasing trend of expectations management, I performed the following regression:

$$Freq_t = \gamma_0 + \gamma_1 TimeTrend_t + \varepsilon_t \tag{1}$$

where *Freq* is the number of firm-quarters providing pessimistic guidance. *TimeTrend* equals 1 if the quarter is 2001Q1, 2 if the quarter is 2001Q2, etc. Regression results are summarized in Table 3 Panel B. γ_1 is significantly negative with a p-value of 0.011, suggesting that firms relying on expectations guidance game have decreased over time in the post-Regulation FD period.

Table 3 Panel C shows the timing of the guidance. *Days_Guidance_Qend* denotes the number of days between the guidance date and the current quarter end. *Days_Guidance_EA* denotes the number of days between the guidance date and the official earnings announcement date. On average, management provides pessimistic guidance one day before the current quarter end and 28 days before the actual earnings announcement date.

In addition, I find (results unreported) that 413 (81.94 percent) firms issued pessimistic guidance in only one quarter during the sample period, 67 (13.29 percent) firms issued pessimistic guidance in two quarters, and 24 (4.77 percent) firms provided guidance in more than two quarters. This evidence suggests that the majority of the firms are "sporadic guiders" and do not engage in expectation guidance activities consistently. I also find (results unreported) that 527 (84.05%) firm-quarters offered an explanation for the pessimistic guidance, such as "order rates did not improve in the quarter as we had expected," or "the severe weather affects our sales adversely." 100 (15.95%) firm-quarters didn't offer any explanation for their guidance.

CONCLUSIONS

This study is one of the first to investigate public managerial discretionary disclosure as a mechanism to manage financial analysts' expectations in the post-Regulation FD period. Through the examination of all public disclosures made in a short period before the actual earnings announcement by 1,073 firm-quarters that successfully switched initial negative earnings errors into positive earnings surprises, I find that 58.4 percent of such firm-quarters issued pessimistic public guidance during the analysis window. This presents direct evidence of expectations guidance activities in the post-Regulation FD era. However, I also find that 40.4 percent of the firm-quarters kept silent. This result suggests that downward forecast revision-based proxies for expectations guidance activities may lead to over-estimating the prevalence of expectations management in the new regulatory environment. In addition, I find that expectations management is decreasing in my sample period.

My analysis regarding the types of pessimistic guidance shows that firms are more likely to use a combination of multiple disclosure forms, both earning-related (e.g. quantitative estimates of earnings and qualitative statements regarding the actual earnings level) and nonearnings-related (e.g. quantitative sales forecasts and qualitative disclosures of other operating information), rather than a single, specific form to guide analysts' estimates.

One limitation of this paper is that it does not address how the passage of Regulation FD changes the expectations management strategy. Firms that relied on informal and private guidance to achieve positive earnings surprises in the pre-Regulation FD period are unable to do so in the post-Regulation FD period.

This study does not address questions like: what types of firms switched from private guidance to public guidance? What types of firms stopped giving guidance due to the new regulation? I leave these questions to future research.

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