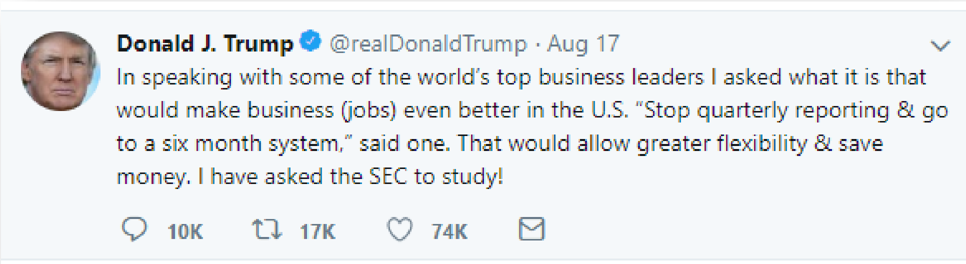
On Sexual Chocolate and Semi-Annual Reporting

Following on the tweet below by President Trump, there is again a lot of discussion of the merits of quarterly reporting, potential corporate short-termism, and the impact it might have on managerial decision-making.



At first blush, the suggestion seems compelling. The logic goes that corporate managers are spending too much time kowtowing to sell-side analysts, and are making short-term decisions in order to achieve investor expectations, or their own guidance, and this is all at the expense of long-term value. The only problem, is it is all wrong. The presupposition that quarterly earnings and guidance somehow breeds short-termism and suboptimal business strategy, just doesn't have much evidence supporting it. In a recent paper "Stock Market Short-Termism's Impact" Professor Mark Roe commented:

> *"None of these predicted economy-wide outcomes (of short termism or quarterly reporting) have been shown. Corporate R&D is not declining, corporate cash is not bleeding out, and the world's developed nations with neither American-style quarterly-oriented stock markets nor aggressive activist investors are investing no more in capital equipment than the U.S.… the calamitous form of the stock-market-driven short-termist argument needs to be reconsidered, recalibrated, and, quite plausibly, rejected."*

In other words, it appears that the consequence of having a portion of shareholders focused on short-term datapoints doesn't necessarily imply short-term management of companies (Exhibits A and B: Google and Netflix). In fact there is an argument that reducing the periodicity of reporting would *increase* the potential for chicanery (by bad management, or by cheaters with inside info). Professors Campbell Harvey and Itzhak Ben-David have even argued that the ultimate goal for pure transparency should be continuous, real-time reporting. They suggest that:

> *"Such a policy (real time financial transparency) would decrease the possibility of misinformation and value distortion."*

Naturally, there can be volatility when companies report, and the "bad" kind of volatility when they report disappointing numbers. Yet, just because the market punishes a stock for bad news doesn't mean it is short term. The market is collectively discounting the future, long-term prospects of the firm back to that very moment. If some fast-growing retailer reports LFLs that are decelerating beyond the biggest bear's imagination, and lowers full year guidance, the stock should fall! Cliff Asness, in his "Shareholder Value is Undervalued" piece a few years back, suggested (and I am paraphrasing):

> *"When management takes action today, in principle and mostly (yes, just mostly, I'll get to that) in fact, the price today moves based on the market's collective assessment of that action's effect on the long-term value of the company. It only looks short-term to those who don't understand this, or don't want to…"*

Barry Ritholz also points out that moving to longer periods between financial reporting would make those earnings reports even *more* significant, with potentially higher volatility around the event. He suggests that:

> *"Moving to twice-a-year reporting will make the event so momentous, with such focus on it that any company that misses analysts' forecasts will find their stock price shellacked."*

Now, there is an argument that quarterly reporting is a good thing, but that offering forward guidance isn't. While this is more reasoned and nuanced claim, we disagree with this too. Companies often set internal targets. No one is against that (in fact, most are for it). And there is no law or SEC mandate stating that companies *must* communicate those targets externally. In other words, companies aren't required to offer guidance. Yet most of them choose to do so. Legislating against this communication doesn't seem very free market.

Good, and Terrible

We believe the elimination of ambiguity is good for the market, and that we all are willing to pay more for something when we have more information and certainty. Take this argument to the extremes and imagine daily vs five-yearly reporting, and this feature becomes more illuminated: After the first four years, is the same company going to have lower volatility and a higher stock price than if they haven't spoken to the market in four years than if they have been transparent the whole way through? No chance. If you want more shareholder value, lower share price volatility and less corporate fraud, report more often, not less.