Stock-Performance Goals in Executive Compensation Contracts and Management Earnings Guidance

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Content:
We examine whether the incentive to achieve stock-performance goals in executive compensation contracts affects managers’ discretionary guidance behavior. Results show that when approaching the end of evaluation period, managers facing Right-Below performance, defined as prevailing stock performance below the lowest performance goal by a small margin, are less (more) likely to issue bad (good) news guidance compared with managers facing other performance zones; however, guidance issued by Right-Below firms does not contain more optimistic bias. Such discretionary guidance behavior regarding the timing of good versus bad news magnifies with the monetary benefits from achieving performance goals and weakens with the costs of exercising discretion and the likelihood of being detected. Consistent with the market unable to fully unravel managers’ discretionary guidance behavior, firms with Right-Below performance have more optimistic analysts’ forecasts and higher abnormal stock returns near the end of the evaluation period. Shortly after the evaluation period ends, Right-Below firms are more likely to issue bad news guidance and experience declining stock prices. The overall evidence is consistent with managers withholding (accelerating) bad (good) news guidance near the end of the evaluation period to boost the likelihood of achieving stock-performance goals.

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All Interested are Welcome