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Analysts' awareness of systematic bias in management earnings forecasts

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Abstract

The effectively mandatory provision of management forecasts of earnings is a unique feature of Japan's financial disclosure system. The first objective of this study is to identify the determinants of systematic bias in management forecasts using a sample of more than 36 000 one-year-ahead earnings forecasts announced by Japanese firms at the beginning of a fiscal year over the period 1979 to 2005. The examination of ex post management forecast errors shows that financial distress, firm growth, firm size and prior forecast errors are all associated with bias in management forecasts. The second objective of this study is to investigate whether analysts are aware of these factors that are found to be related to systematic bias in management to the announcement of management forecasts reveals that analysts take account of these factors when they issue their own earnings forecasts. The overall findings suggest that

analysts are to some extent aware of the determinants of systematic bias in management forecasts.

Keywords:					
management earnings forecasts	analysts' earnings forecasts	determinants of forecast bias			
forecast accuracy					
JEL Classification:					
G15 G14					

Notes

¹ The term 'earnings' used in this article indicates 'net income' unless otherwise stated.

² The condensed financial statements are available from the Tokyo Stock Exchange (TSE) website (<u>http://www.tse.or.jp</u>).

³ All forecasts for the upcoming year are publicized in the form of point forecasts except for dividends per share that are sometimes provided in the form of range forecasts.

⁴ A survey reports that already in 1980, more than 90% of listed firms excluding those in the financial sector provided management forecasts. A more recent survey in 2006 reports that 3790 of the 3831 listed firms (98.9%) including financial institutions provided management forecasts.

⁵ Although most of the literature on management forecasts uses the US data, there are some studies that make use of the data outside the US (Mahipala et al., <u>2009</u>; Hartnett, <u>2010</u>).

⁶ The sample period is limited to 1979 to 2005 due to the difficulty in collecting forecast data. Both management and analysts' earnings forecasts are hand-gathered from the Nihon Keizai Shinbun (the major business newspaper in Japan) and the Kaisha Shikihou (the Japan company quarterly handbook), respectively. ⁷ See Japan Securities Research Institute (<u>2006</u>) for further details on the equity markets in Japan.

⁸ The JASDAQ market became a regular stock exchange in December 2004.

⁹ The management and analysts' earnings forecast data are available upon request from the author. Also note that the management forecast data after the year 2000 are available from Nikkei Media Marketing Inc.

¹⁰ I am grateful to an anonymous referee for suggesting this point.



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