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Self-serving Bias in Annual Report Narratives: An Empirical Analysis of the Impact of Economic Crises

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Abstract

Consistently, management's explanations of corporate performance in accounting narratives have been found to suffer from self-serving bias. Yet there is no unequivocal evidence as to whether this bias is the product of conscious efforts to manage the impressions of the audience or the result of unintentional cognitive biases. The present study contributes to this discussion by comparing the narratives of the letters addressed to shareholders of Europe's most highly-capitalized companies in crisis and non-crisis settings. We find that a crisis situation leads to more extensive use of self-serving bias as adverse external economic conditions are used by managers to present themselves in the best possible light. Given that the letters to shareholders are widely used for capital allocation decisions and considering the evidence that intentional self-serving behavior can be successful, our results imply that investors need to be alert to misleading explanations of performance, particularly during external crises. The International Accounting Standards Board (IASB) has formulated a practice statement proposing non-mandatory guidance on the management commentary that accompanies financial statements. Our results suggest that the quality of narrative information in annual reports is unlikely to be augmented by guidelines that encourage the discussion of corporate performance through the eyes of management.

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