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# IMPACT OF REPORTING FREQUENCY ON UK PUBLIC COMPANIES

Robert Pozen, Suresh Nallareddy,  
and Shivaram Rajgopal



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978-1-944960-17-9

March 2017

# CONTENTS

- Introduction and Summary ..... 1
- 1. The EU and UK Regulatory Context before 2007 ..... 3
- 2. Impact of the 2007 Changes in the United Kingdom..... 5
- 3. The Regulatory Context of Stopping Quarterly Reports ..... 10
- 4. Removal of the Quarterly Reporting Requirement ..... 12
- Conclusions and Implications ..... 16
- References ..... 19



# IMPACT OF REPORTING FREQUENCY ON UK PUBLIC COMPANIES

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Authors' Note: This study was financed in part by a grant from the CFA Institute Research Foundation. The authors express deep appreciation to Emilio Lamar, an MIT senior, for his excellent work on the references.

## INTRODUCTION AND SUMMARY

Corporate executives have long decried the undue emphasis on short-termism—defined as maximizing corporate profits in the next quarter. Instead, most corporate executives say that they want to make corporate investments from a long-term perspective—defined as enhancing corporate value over a period of three to five years (Rappaport 2006).

This concern about favoring short-termism over long-termism has now spread to institutional investors (Perrin 2016). In an open letter, Laurence Fink, CEO of BlackRock, warned US companies that they may be harming their long-term value by capitulating to pressures from activist hedge funds to increase dividends or share buybacks in the short term (Fink 2015).

In response, commentators and regulators have proposed a broad range of remedies to curb short-termism in corporate America (Pozen 2014). These proposals include, but are not limited to, higher taxes on short-term trading, faster filings for groups acquiring more than 5% of a company's voting stock, reduced say by institutional investors in managerial decisions, and increased voting rights for shareholders based on the length of their holding period.

## IMPACT OF REPORTING FREQUENCY ON UK PUBLIC COMPANIES

Of particular interest to CFA members are the calls for public companies to issue earnings reports on a semiannual rather than quarterly basis. This proposal was put forth by a distinguished American lawyer (Benoit 2015) and was discussed at a recent SEC hearing (SEC 2015). Even former Secretary of State Hillary Clinton has expressed concern about the adverse effects of quarterly reporting on the long-term profitability of American corporations (Udland 2016).

Over the last decade or so, Europe has engaged in a “natural experiment” on the effects of reporting frequency. In its 2004 Transparency Directive, the European Commission announced that by early 2007 all EU member states must require their public companies to issue interim management statements (IMS) on a quarterly basis (European Parliament and Council 2004). However, in its 2013 amendments to the directive, the European Commission reversed direction by removing this requirement (European Commission 2013).

We undertook this study to assess the actual impact of the frequency of company reporting on UK public companies. Specifically, this study looked at the effects on UK corporate investments and capital markets of moving to required quarterly reporting in 2007 and then dropping this requirement in 2014.

Most importantly, this study found that the initiation of required quarterly reporting in 2007 had no material impact on the investment decisions of UK public companies. As discussed in Section 2A, the study measured this impact by examining, before and after these changes in reporting requirements, the companies’ capital expenditures; spending on research and development; and spending on property, plant, and equipment.

By contrast, the initiation of mandatory quarterly reporting in 2007 was associated with significant changes in other areas. An increasing number of companies published more qualitative than quantitative quarterly reports and gave managerial guidance about future company earnings or sales. At the same time, there was an increase in analyst coverage of public companies and an improvement in the accuracy of analyst forecasts of company earnings.

When quarterly reporting was no longer required of UK companies in 2014, less than 10% stopped issuing quarterly reports (as of the end of 2015). Again, there was no statistically significant difference between the levels of corporate investment of the UK companies that stopped quarterly reporting and those that continued quarterly reporting. However, there was a general decline in the analyst coverage of stoppers and less of such decline for companies continuing to report quarterly.

Companies that stopped quarterly reporting manifested two characteristics: They were relatively small by market capitalization, and they did not issue managerial guidance



during the period of mandatory quarterly reporting. Energy companies were the most prevalent stoppers, followed by utilities.

This brief is organized into four parts, plus a final section on “Conclusions and Implications”:

1. We first review the UK context for quarterly financial reports before the regulatory change in 2007.
2. We summarize the effects from 2007 onwards on companies initially switching to quarterly reporting in 2007.
3. We review the key forces behind the move away from required quarterly reporting in 2014.
4. We summarize the effects on companies that stopped issuing quarterly reports beginning in 2014.

## 1. THE EU AND UK REGULATORY CONTEXT BEFORE 2007

Before 2007, UK public companies were required to issue annual and semiannual earnings reports together with financial statements—balance sheets and income statements (Withers 2008). In addition to these regular reports, UK companies also had—and continue to have—an obligation to publicly disclose material inside information on an ongoing basis, although companies have a right to delay publication of such information for a limited time for limited reasons (FCA 2016, Sec. 2.5). But UK companies are prohibited from selectively disclosing material inside information, except confidentially in the normal exercise of employment or professional or other duties, such as disclosures to lawyers and accountants (FCA 2016, Sec. 1.4).

Before 2007, UK companies were also encouraged by regulators to issue “trading statements” in order to meet their continuing obligation to disclose material updates between annual and semiannual reports without violating the restriction against selective disclosure.<sup>1</sup> For example, a company might issue a trading statement to announce sales trends in retail stores or subscription renewals for mobile phones. Before 2007,

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<sup>1</sup>A trading statement is essentially an update on a company’s revenues and other financial measures. Before 2007, some companies also issued “pre-closing” statements with profit warnings.

however, the UK listing rules did not contain a requirement to issue quarterly financial reports, although some listed companies voluntarily issued such reports.<sup>2</sup>

For a decade before 2007, the European Commission tried to introduce more transparency for investors through a regular flow of information based on a harmonized system of quarterly reports and financial statements (Link 2012). However, in response to opposition from several member states, including the United Kingdom, the commission decided to support a compromise—the requirement that companies publish interim management statements (IMS) unaccompanied by financial statements. Instead, the IMS was to contain the following:

an explanation of material events and transactions that have taken place during the relevant period and their impact on the financial position of the issuer and its controlled undertakings, and a general description of the financial position and performance of the issuer and its controlled undertakings during the relevant period. (European Parliament and Council 2004, Art. 6.1)

The IMS was adopted as part of the Transparency Directive by the European Parliament and the European Council in 2004. All member states had to incorporate this directive into their national legislation by January 2007, though member states could add other reporting requirements as well (European Parliament and Council 2004, Art. 3.1). In the United Kingdom, the Financial Services Authority (FSA) implemented this directive through its Transparency Rules, which were combined with the FSA's existing disclosure rules to form the renamed Disclosure and Transparency Rules (DTR; FSA 2006).

For fiscal years beginning after 20 January 2007, the DTR required all UK public companies to issue an IMS for each of the first and third quarters in addition to their annual and semiannual reports with financial statements. The DTR's guidelines for an IMS took an approach to disclosure similar to that embodied in the wording of the Transparency Directive of the EU, quoted above. But the DTR did not require the issuance of an IMS by a UK company already issuing quarterly reports in accordance with the rules of a regulated market, the rules of another country, or its own volition (Jones Day 2007).

At about the same time, the United Kingdom adopted significant changes to the liability provisions of UK law by establishing the new Section 90A of the Financial Services and Markets Act (FSMA) to delineate company liability for any untrue or materially misleading statement or omission in an annual report, semiannual report, IMS, or any voluntary preliminary statement published in advance of a report or statement (Morrison

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<sup>2</sup>Cuijpers and Peek [2010] examined certain capital market characteristics of firms that voluntarily issued quarterly reports before 2007. They found that such voluntary reporters had lower bid–ask spreads and higher share turnover than firms that did not choose to issue quarterly reports.

& Foerster 2010). Under Section 90A, companies are liable to pay damages to investors who suffer a loss as a result of any untrue or misleading statement in the relevant published information or any omission of matter required to be included therein. However, a company is liable only if a person discharging managerial responsibilities in relation to the publication

- knew that the statement was untrue or misleading,
- was reckless as to whether the statement was misleading, or
- knew the omission constituted a dishonest concealment of a material fact.

Also, the investor must have acquired securities in reliance on the untrue or misleading information when it was reasonable for the investor to rely on that information.

Under the provisions of Section 90A, mere negligence on the part of the company or its management team does not give rise to liability. On the other hand, Section 90A states that it does not displace or affect existing sources of potential company liability, including the courts' power to order restitution under the FSMA, the authority of the FSA (now the FCA) to require restitution under the FSMA, liability for a civil penalty under common law, and criminal liability (Morrison & Foerster 2010).

## 2. IMPACT OF THE 2007 CHANGES IN THE UNITED KINGDOM

When the new quarterly reporting requirements became effective in the United Kingdom in February 2007, all publicly traded companies in the country were publishing an annual report and a semiannual report accompanied by financial statements—a balance sheet and income statement. According to interviews with accountants, external auditors typically reviewed (but did not audit) the semiannual reports of the larger public companies traded in the main London market but not the semiannual reports of smaller public companies traded on London's alternative investment market (AIM).

To conduct our study, we divided UK public companies into two groups as of the start of 2005. The first group consisted of the voluntary adopters, companies that had voluntarily decided to issue quarterly reports before 2007 (224 companies as of 2007).<sup>3</sup> The second group consisted of the mandatory switchers, companies that began issuing quarterly reports only later in 2007 in response to the new UK requirements (515

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<sup>3</sup>Voluntary adopters were defined to include companies that regularly issued trading statements.

companies as of 2008).<sup>4</sup> According to interviews with accountants, the quarterly reports of both groups of companies were rarely reviewed by their external auditors (absent a capital-raising transaction for the company).

As discussed below, we assessed the impact of the new 2007 requirement on both groups of companies with respect to the level of corporate investment, the content of the quarterly reports, the incidence of managerial guidance, and the extent of analyst coverage.

## A. LEVEL OF CORPORATE INVESTMENT

We attempted to test the hypothesis that more frequent company reporting focuses management on the short term and therefore leads to lower levels of longer-term investment.<sup>5</sup> If this hypothesis were correct, we would expect to see lower levels of longer-term company investment after 2007 than before that date for mandatory switchers. In summary, as shown in **Figure 1**, we did not find statistically significant differences in the changes in the level of company investment for mandatory switchers as compared to voluntary adopters between 2007 and 2010. Because of the potential exogenous effect of the global financial crisis in 2008, we did a separate analysis of the data on these same companies from 2010 through 2013. Again, during that period, we found no statistically significant differences in the changes in the level of company investment for mandatory switchers as compared to those of voluntary adopters.

In particular, we looked at the effect of initiating mandatory reporting on three measures of relatively long-term investments: capital expenditures; research and development; and net property, plant, and equipment. If more frequent reporting induces a short-term mindset in company executives, we would expect to see lower levels of relatively long-term investment for mandatory switcher companies from 2007 onwards than before 2007. We also might expect that from 2007 onwards the level of corporate investment by mandatory switchers would decline more than such decline for voluntary adopters, since the latter were already accustomed to quarterly reporting.

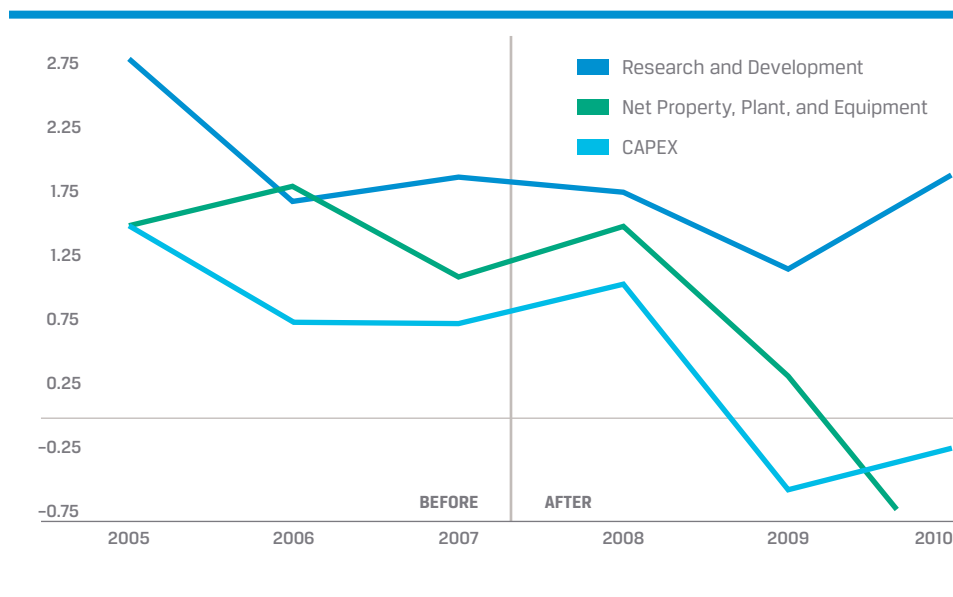
Nevertheless, using a difference-in-difference methodology, we found no statistically significant results in either case for mandatory switchers. To clarify, the difference-in-difference method detects changes in long-term investments before and after 2007 for mandatory switchers compared to changes in long-term investments before and after

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<sup>4</sup>The 515 companies include all those switchers with fiscal years ending in 2008. Ernstberger, Link, Stitch, and Vogler (2017) claimed that mandatory reporting in the UK increased earnings management, proxied by abnormal production and lower discretionary expenses. However, that study excluded voluntary adopters and examined only mandatory switchers.

<sup>5</sup>Kraft, Vashishtha, and Venkatachalam (2016) concluded that more frequent reporting led to lower capital investments; however, that study was based on US data from the 1970s.

**FIGURE 1. DIFFERENCE IN CORPORATE INVESTMENT BETWEEN VOLUNTARY REPORTERS AND MANDATORY SWITCHERS**



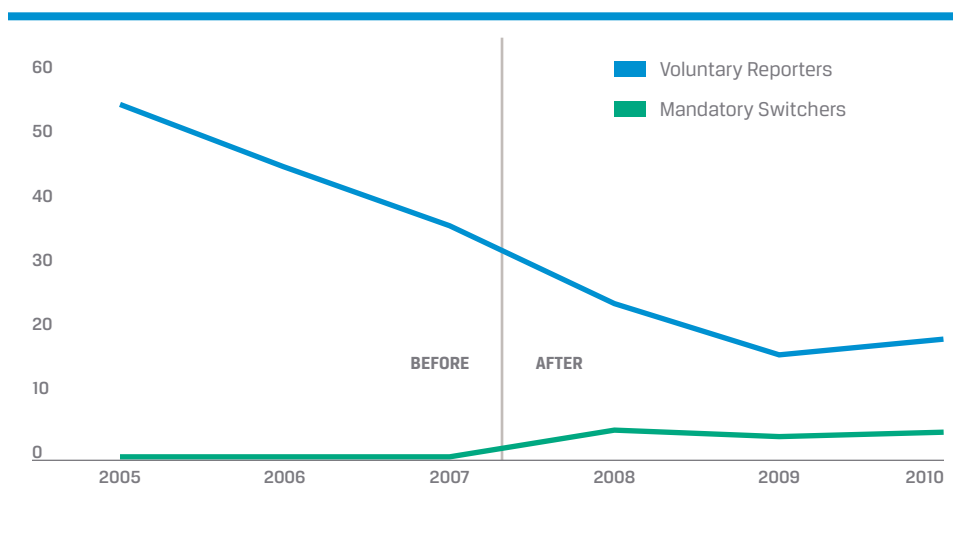
2007 for voluntary adopters. That is, the decline in investments for mandatory switchers should materially exceed the analogous decline for voluntary adopters in order for our statistical tests to flag such a decline for mandatory switchers as statistically significant. The difference-in-difference methodology is considered a rigorous statistical approach to evaluating the impact of a policy change—in this case, the imposition of mandatory quarterly reporting.

## B. CONTENT OF QUARTERLY REPORTS

In 2005, 52% of the voluntary adopters included both earnings and sales information in their quarterly reports. We refer to these as quantitative reports, as distinguished from qualitative reports. As shown in **Figure 2**, the percentage of voluntary adopters issuing quantitative reports began to decline after 2005 and declined more from 2007 to 2009, when the percentage leveled off. In that same year, only 5% of mandatory switchers issued quantitative reports as defined above.

We believe that the marked shift from quantitative to qualitative quarterly reports by voluntary adopters occurred because the UK authorities, like their EU counterparts, did not require financial statements in quarterly reports. Instead, the UK authorities provided flexible guidelines, with an emphasis on qualitative information. For the same reason, almost all of the quarterly reports of UK mandatory switchers from 2007 onwards were qualitative.

**FIGURE 2. CONTENT OF QUARTERLY REPORTS: % OF FIRM REPORTS THAT INCLUDE EARNINGS AND SALES**



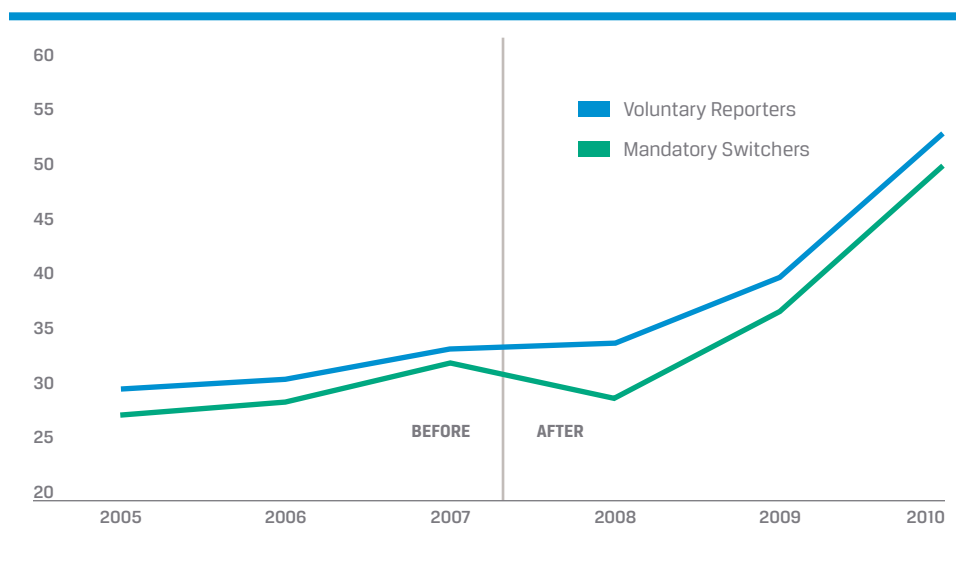
Given the flexibility and vagueness of the UK regulatory guidance, the length and content of quarterly reports of both voluntary adopters and mandatory switchers varied tremendously. Some quarterly reports, running from 10 to 15 pages, provided detailed information about most components of the company’s past performance. Other quarterly reports, only a few pages long, gave a cursory overview of the company’s activities over the previous three months.

### C. MANAGERIAL GUIDANCE ON FUTURE EARNINGS OR SALES

We also looked at the proportion of UK companies whose management publicly announced guidance to investors on the next year’s earnings or sales. As shown in **Figure 3**, in 2005, only 30% of the voluntary adopters issued such managerial guidance on the company’s prospects during the next year. This percentage increased substantially to 53% in 2010. Similarly, in 2005, only 28% of the mandatory switchers issued managerial guidance on the coming year’s prospects. The percentage for mandatory switchers increased to 49% in 2010—closely paralleling the pattern for voluntary reporters.

In the US context, several commentators have argued against issuing managerial guidance because it allegedly focuses managers’ attention on the next quarter’s results rather than on longer-term investments. While there are several studies supporting this argument, at

**FIGURE 3. MANAGERIAL GUIDANCE: % OF FIRM REPORTS THAT PROVIDE EARNINGS OR SALES GUIDANCE**



least one published study comes out against it.<sup>6</sup> Moreover, it bears noting that managerial guidance is quite different in the United Kingdom than in the United States.

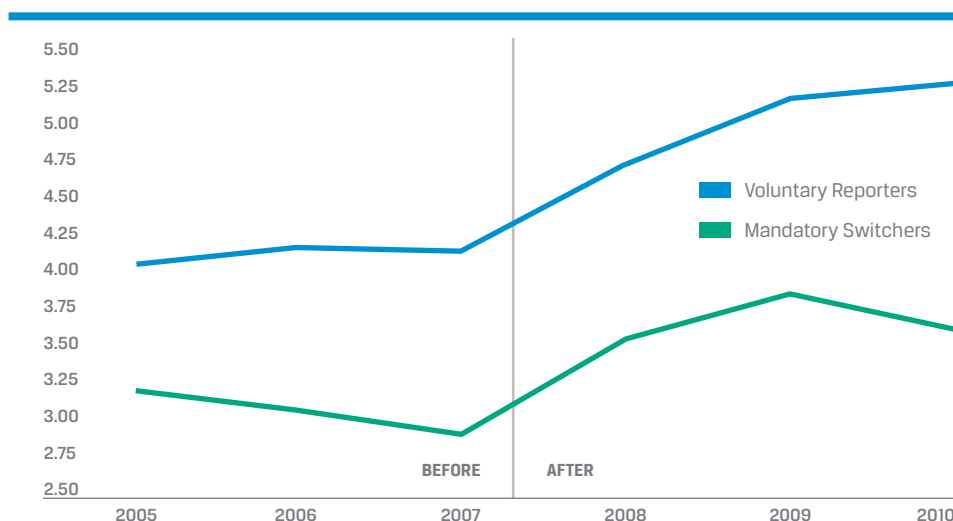
For example, managerial guidance in the United Kingdom is usually for the next year—rather than for the next quarter, as it is in the United States—though UK companies sometimes adjust their annual guidance when issuing a quarterly report. Similarly, UK companies typically announce guidance on a broad range of the next year’s aggregate earnings or sales, rather than a more specific projection on earnings per share, as often occurs in the United States. According to UK analysts, earnings per share is not used as much in Europe as in the United States because of the many accounting and tax differences among European countries, which affect the computation of this financial metric.

#### D. EXTENT OF ANALYST COVERAGE

Finally, we looked at the impact of the quarterly reporting requirement on analyst coverage of both groups of companies from 2007 onwards, as compared to the period before 2007. As shown in **Figure 4**, from 2007 to 2009, the average number of analysts following the mandatory switchers went from 2.79 to 3.39—an increase of 21.5%. Yet the increase in the average number of analysts following the voluntary adopters was even larger—from 3.77 to 4.78, an increase of 26.5%.

<sup>6</sup>Graham, Harvey, and Rajgopal (2006) found that in the United States a majority of CFOs were willing to delay profitable investments in order to meet quarterly earnings projections (but see Call, Chen, Miao, and Tong 2014).

**FIGURE 4. AVERAGE NUMBER OF ANALYSTS COVERING COMPANY**



These results are subject to conflicting interpretations. The introduction of quarterly reporting provided more company information about mandatory switchers for analysts to examine and perhaps drew more analyst attention to the quarterly reports of voluntary adopters. On the other hand, some analysts argued in interviews that their potential added value was higher when public companies issued only semiannual reports, because less frequent information made generating accurate forecasts of quarterly earnings more difficult.

One finding relevant to this debate is that the error in analysts' annual earnings forecasts declined more for mandatory switchers than for voluntary adopters after 2007. This finding would help explain why more analysts began covering mandatory switchers once they were required to issue quarterly reports, though it obviously does not explain the larger increase in analysts following the voluntary switchers after 2007.

### 3. THE REGULATORY CONTEXT OF STOPPING QUARTERLY REPORTS

In 2012, the UK government asked John Kay, a distinguished academic and journalist, “to review activity in UK equity markets and its impact on the long-term performance and governance of UK quoted companies.” After conducting an extensive review, Kay concluded in his final report “that short-termism is a problem in UK equity markets,



and that the principal causes are the decline of trust and the misalignment of incentives throughout the investment chain” (Kay 2012, p. 9).

In response, the final report made 17 recommendations for changes. The eleventh recommendation was to eliminate mandatory quarterly reporting. But it bears noting that the report called for much broader reforms. Its initial 10 recommendations included the adoption of a stewardship code, the establishment of a forum for collective engagement by investors, the phasing out of management guidance on earnings expectations, the clarification of fiduciary duties of trustees and their advisers, and the rebating to investors of all income from stock lending.

After a review starting in 2010, the European Commission amended the EU’s Transparency Directive in 2013 to remove the quarterly reporting requirement. The commission gave two main reasons for removing this requirement—to reduce the administrative burden on issuers and to encourage long-term investment:

A thorough impact assessment was carried out before the Commission proposed to abolish this requirement. Its results show that quarterly financial information is not necessary for investors’ protection even if it can provide useful information for some investors. Investor protection is already guaranteed through the mandatory disclosure of half-yearly and yearly financial results, as well as through the disclosures required by the Market Abuse Directive. (European Commission 2013, p. 2)

Although the amendments to the EU’s Transparency Directive did not mandate action by member states until November 2015, the Financial Conduct Authority (FCA) of the United Kingdom proceeded to remove its quarterly reporting requirement in November 2014. But the FCA emphasized the need for companies that stopped issuing quarterly reports to disclose price-sensitive information as soon as practical. While UK companies could still voluntarily choose to issue quarterly reports, the FCA said specifically that it would “not be providing any guidance on the publication of voluntary reports” (FCA 2014, Sec. 2.5).

The FCA did say that quarterly reports voluntarily issued by UK public companies would no longer constitute “regulated information” under certain provisions of UK law (FCA 2014, Sec. 2.5). Therefore, voluntary reports would not be required to be published via a regulated information processor. Nevertheless, these voluntary quarterly reports would still be covered by the liability provisions in Section 90A of the FSMA, discussed above. Section 90A was amended in 2010 expressly to apply to any document issued by a publicly traded company using a regulated service for disseminating information to the market.

## 4. REMOVAL OF THE QUARTERLY REPORTING REQUIREMENT

After the United Kingdom removed the requirement for quarterly reports in November 2014, we examined the number and characteristics of those public companies that stopped issuing quarterly reports (“stoppers”) versus those public companies that kept issuing quarterly reports (“continuers”). We also compared these two groups of companies with respect to their levels of corporate investment and the extent of analyst coverage.

### A. CHARACTERISTICS OF STOPPERS AND CONTINUERS

From November of 2014 until the end of 2015, very few UK companies became stoppers. Of the 471 UK public companies in our sample for 2014, only 45 (less than 9%) decided to stop quarterly reporting by the end of 2015. The stoppers all shared two characteristics: They were relatively small by market capitalization, and they did not provide managerial guidance during the period when quarterly reports were required.

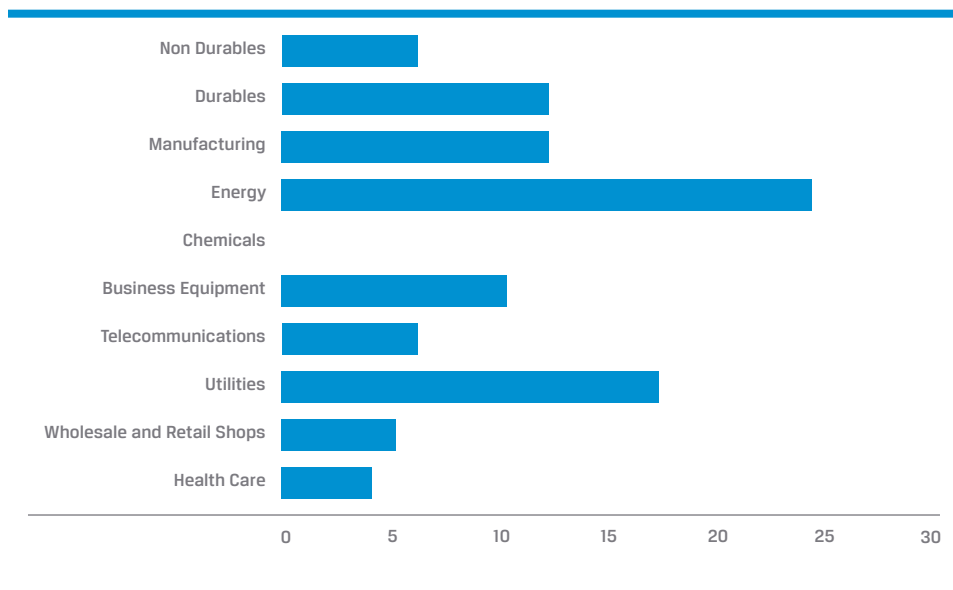
The small firm size was probably related to the nature of the stoppers’ shareholder base. These companies probably had few shareholders from countries (like the United States) where quarterly reporting is the norm. The absence of managerial guidance can be interpreted as indicating a general preference for disclosing less information to investors.

**Figure 5** shows the industries represented by the 45 stoppers. The stoppers were concentrated in the energy industry and, to a lesser extent, utilities. Both these industries have very long investment horizons, so these companies may have been reluctant to engage in quarterly reporting. In addition, many energy companies suffered deep losses in 2015, so they might have been reticent about disclosing bad news more often.

The reluctance of stoppers to disclose information voluntarily to investors is reinforced by another finding. Of the 45 stoppers after November 2014, only 9 were voluntary adopters of quarterly reporting before it became mandatory in February 2007. By contrast, many of the continuers after November 2014 had been voluntary adopters of quarterly reporting before February 2007. This finding suggests that continuers were generally predisposed to provide more company information to investors than stoppers were.

After the removal of the quarterly reporting requirement in 2014, the continuers followed the same disclosure practices that they had followed between 2007 and 2013. Specifically, the nature of the continuers’ quarterly disclosures was more qualitative than quantitative. Similarly, a large portion of the continuers kept issuing managerial guidance after 2014.

**FIGURE 5. 45 STOPPERS: INDUSTRY REPRESENTATION**



## B. WHY SO FEW STOPPERS

We have debated the question of why so few UK companies decided to stop quarterly reporting as of 2014. Perhaps corporate executives had already developed the internal processes for quarterly reporting, so the incremental administrative burdens were relatively light. Absent any regulatory guidance, they were free to customize their quarterly statements by providing qualitative disclosures—without either balance sheets or income statements.

As the FCA emphasized, corporate executives may have been concerned that without quarterly reporting, they would have to make more episodic disclosures of market-sensitive information. According to our interviews, such disclosures tend to be reactive to unexpected events, while corporate executives prefer to manage their relations with investors proactively.

Finally, certain companies may be disposed toward quarterly reporting because of their economic situation. For example, some executives may understand the need for quarterly comparisons in industries with substantial variation in short-term results, such as retail stores and computer games. Others may be worried about the negative signaling effects of stopping quarterly reports, especially if business prospects are actually strong. Still other companies may have industry peers or a dual listing in the United States, where quarterly reporting is required.

Of course, UK corporate executives could argue that their shareholders insisted on the continuation of quarterly reports. However, the United Kingdom has already adopted other reforms suggested by the Kay report, such as the investor forum to promote long-term value creation. The Kay report also led to a review by the UK Law Commission aimed at clarifying that fiduciary duties do not require the maximization of short-term financial returns. Recently, the main association of UK asset managers called for an end to quarterly reporting (Investment Association 2016, p. 17).

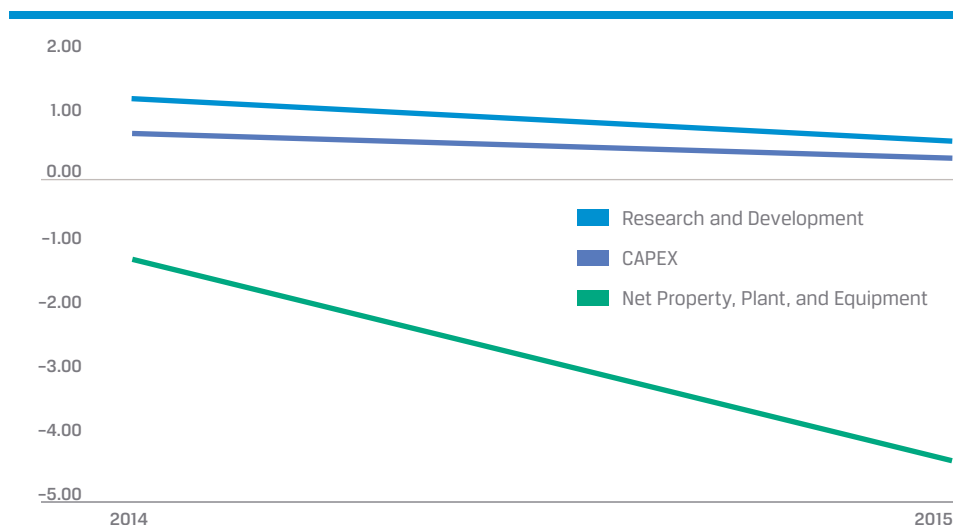
### C. LEVEL OF CORPORATE INVESTMENT

Although the number of stoppers was relatively low after the change in the regulatory requirement, we examined whether these stoppers made more corporate investments from 2014 onwards than they had before 2014. In this examination, we used the same measures that we applied before and after 2007, as described in Section 2: capital expenditures; research and development; and net property, plant, and equipment.

If less frequent company reporting leads to more longer-term company investments, we should see the difference in the levels of company investment before and after firms stopped issuing quarterly reports in 2014. However, we did not find statistically significant differences in stoppers' company investments before and after 2014.

Similarly, if less frequent company reporting leads to more longer-term company investments, we should see a difference in the levels of company investment between those firms that stopped issuing quarterly reports and those that continued to issue such reports from 2014 onwards. As shown in **Figure 6**, however, we did not find any material changes in the differences between stoppers and continuers from 2014 to 2015 with respect to capital expenditures (CAPEX) and research and development. Although there was a modest increase in the difference between these two groups with respect to net plant, property, and equipment during this period, the increase was not statistically significant.

**FIGURE 6. DIFFERENCE IN CORPORATE INVESTMENT BETWEEN QUARTERLY REPORTERS AND STOPPERS**

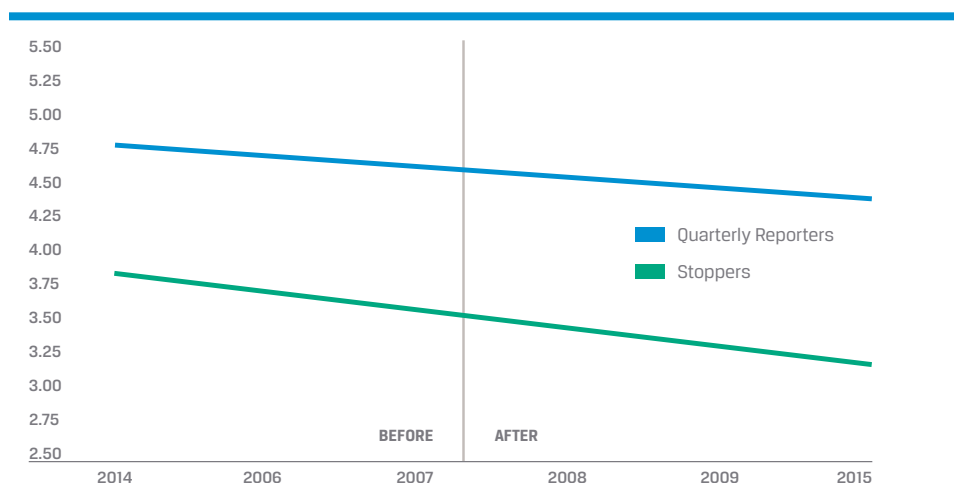


## D. EXTENT OF ANALYST COVERAGE

Finally, we examined the effects on analyst coverage when firms stopped issuing quarterly reports (see **Figure 7**). Using a difference-in-difference methodology, we did find that the stoppers experienced a significant decline in analyst coverage, though analyst coverage also declined to some degree for firms that continued to report quarterly. The steeper decline for stoppers may be related to two facts: that stoppers tended to be smaller firms and that they did not provide managerial guidance when they were issuing quarterly reports.

As discussed above, when mandatory quarterly reporting was introduced in the United Kingdom, we found more significant declines in the errors in analysts' earnings forecasts for mandatory switchers than in those for voluntary adopters. However, we found no statistically significant increase in forecast errors for analysts of stoppers after those companies stopped issuing quarterly reports, as compared to the period when they did issue quarterly reports. This finding suggests that analysts who kept following the stoppers found ways other than quarterly reports to learn important information about these companies' prospects.

**FIGURE 7. AVERAGE NUMBER OF ANALYSTS COVERING COMPANY**



## CONCLUSIONS AND IMPLICATIONS

The main conclusion of this brief is that the frequency of a UK company’s earnings reports does not materially affect its level of corporate investment. When companies were forced to report quarterly rather than semiannually in 2007, we did not find a statistically significant reduction in the level of investment made by the companies that were switching to quarterly reporting for the first time, as compared with the voluntary reporters from before 2007. Similarly, when companies were allowed to stop quarterly reporting in favor of semiannual reporting in 2014, we did not find any statistically significant increase in the level of investment made by these stoppers, as compared with companies that continued reporting. For the purposes of our study, investment included capital expenditures; spending on research and development; and spending on property, plant, and equipment.

In short, contrary to the rationale behind the 2013 amendments to the EU Transparency Directive, moving from quarterly to semiannual reporting is not an effective remedy for undue corporate emphasis on short-termism. If quarterly reporting leads company executives to focus on profits during the next three months, then a shift to semiannual reporting might plausibly lead corporate executives to focus on profits during the next six months—not on corporate investments with good prospects over the next three to five years.

If regulators and politicians want companies to take a longer-term approach to investments, they should pursue broader reforms than shifting from quarterly to semiannual reporting. One possibly fruitful approach would be to lengthen the duration of executive pay. A study found that pay duration is longer in companies with more growth opportunities, more long-term assets, greater research intensity, and a lower risk appetite (Gopalan, Milbourn, Song, and Thakor 2014). Other thoughtful proposals made in the Kay report include encouraging asset managers to collectively engage with their portfolio companies, focusing the role of directors on their stewardship of the assets and operations of their companies, and developing metrics of company performance that are directly relevant to long-term value creation.

Nevertheless, a shift from semiannual to quarterly reporting does have a significant impact on the relationships between UK public companies and security analysts. Companies reporting quarterly attract a larger following of security analysts, and those analysts' earnings estimates improve. Conversely, when companies stopped reporting quarterly, there was a decline in their analyst coverage but no significant change in the accuracy of analyst estimates for these companies.

Other researchers should carry out empirical studies in Europe about the effects of managerial guidance on company investments. Several US commentators have argued that when executives project the next quarter's earnings for their companies, they are directing the attention of their analysts and shareholders to short-term results. While this argument has substantial, but not unanimous, support in the US literature, further research should take into account the significant differences between the nature of managerial guidance in Europe and in the United States.

Some commentators have suggested that semiannual reporting may lead to more insider trading than quarterly reporting (Pozen and Roe 2015). This argument seems logical because there would be longer "dark" periods without a quarterly reporting requirement. On the other hand, the United Kingdom imposes strict obligations on public companies to disclose material events between regular reports and strict prohibitions against selective disclosure of insider information. Thus, this argument should be tested by rigorous empirical studies relating the incidence of insider trading to the frequency of regular company reports.

Researchers should also examine the behavior of analysts when they follow companies that report only semiannually. One recent study suggests that, lacking earnings reports from a company in the first and third quarters, analysts fill the information vacuum by looking at the quarterly earnings reports of peer companies in the same industry but in other countries. Unfortunately, according to that study, analysts in this situation tend to overreact to the earnings trends of peer companies, especially if those companies are showing declines in earnings (Arif and De George 2015).



## IMPACT OF REPORTING FREQUENCY ON UK PUBLIC COMPANIES

We have debated the question of why so few UK companies stopped quarterly reporting after it was no longer required in 2014. One possible explanation is that these companies had already incurred the cost of establishing processes for quarterly reporting and that their shareholders had become accustomed to quarterly reports. This explanation is supported by the fact that the stoppers of quarterly reporting tended to be smaller companies with a less global shareholder base.

Another possible explanation stresses the industry groups of the companies that stopped quarterly reporting after November 2014. The largest groups of stoppers were energy companies and utilities. Both types of companies have a much longer horizon for investing than other industries, such as retail and software. In addition, a public company with a dominant shareholder may be more likely to stop quarterly reporting because management does not feel as vulnerable to activist hedge funds as in a company with a widely dispersed shareholder base.

In sum, with these few exceptions, most UK companies seem likely to continue to publish quarterly reports, and most CFA Institute members continue to support the issuance of quarterly reports (Kunte 2015). We recognize that quarterly reports are more burdensome to smaller companies than to larger ones. Nevertheless, we would be reluctant to drop quarterly reports for smaller public companies while retaining them for larger public companies. That division might well prove counterproductive, reducing the liquidity of trading markets for smaller companies and raising their cost of capital.

Instead, we favor a better approach to quarterly reporting for companies of all sizes. The high volume of information required by the SEC in quarterly filings on Form 10-Q—in addition to full financial statements—seems unduly burdensome for public companies and hard to understand for most investors. We believe that the UK authorities' more flexible guidelines for interim management statements may establish the basis for a reasonable compromise in the form of a streamlined quarterly report.

In designing such a report, we would suggest that a regulator formulate a specific set of guidelines for each major sector.<sup>7</sup> Such guidelines would recognize the very different time horizons of different sectors and allow investors to easily compare the performance of firms in a given sector. We would also suggest that companies promulgate their own key performance indicators (KPIs) for the long-term success of their main business segments and provide concrete data on the company's progress in achieving these KPIs each quarter. This approach would allow company executives to focus their detailed reporting on what they believe are the critical drivers of company success.

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<sup>7</sup>In another context, for example, the Sustainability Accounting Standards Board (SASB) has specified metrics by sector and industry.



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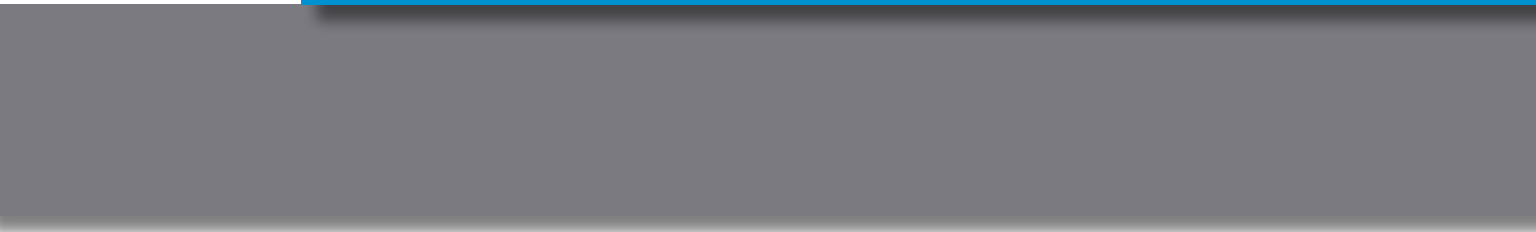
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