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THE INTELLIGENT INVESTOR

# The End of Quarterly Reporting? Not Much to Cheer About

Investors are still likely to overreact to disappointments, while it's not clear whether less reporting will change corporate behavior



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*By**Jason Zweig*

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President Trump proposed Friday that public companies should report their financial results only twice a year instead of quarterly.

Such a move, he implied, would reduce companies' costs of complying with bureaucratic red tape and help corporate executives focus on longer-term goals. Mr. Trump called on the

Securities and Exchange Commission to study the feasibility of scaling back the frequency of corporate reporting.

The proposal is in the same spirit as the suggestion by investor Warren Buffett and JPMorgan Chase & Co. Chief Executive James Dimon that companies should reduce or eliminate quarterly earnings “guidance,” in which management hints at the health of profits before final numbers are reported.

But is it a good idea? How much difference would it make?

As my colleague James Mackintosh has pointed out, there isn’t much macroeconomic evidence to support the notion that reporting of short-term financial results pressures companies into compromising their long-term goals. Companies are spending more on research and development than ever before, for example.

That isn’t how corporate insiders see it, however. In a 2003 survey of chief financial officers of public companies, finance professor Campbell Harvey of Duke University and his colleagues found that 78% of these executives would sacrifice long-term value in order to hit their quarterly earnings targets. Many of the CFOs also conceded they would cut spending, delay starting a beneficial project or book revenues ahead of time to meet short-term earnings expectations.

“What’s really shocking is that 78% *admitted* destroying value to hit an earnings target,” says Prof. Harvey. “The real numbers could be higher. We want our business leaders making decisions that are good for the long-term health of our country instead of just for the quarter at hand.”

In a 2014 survey of giant pension-fund investors, Prof. Harvey found that most favored semiannual or annual over quarterly reporting, partly because less-frequent reports appear to lower the temptation for corporate executives to play games with earnings targets.

It isn’t certain, though, that moving from quarterly to semiannual reporting would stop corporate managers from cutting any corners. “If companies report only every six months, then there could be more damage, not less,” says Mark Roe, a professor of corporate and business law at Harvard Law School. Without quarterly updates, “the stock price could drift even farther out of whack from fundamentals, and then the temptation for management to distort earnings could potentially be even greater.”

Of course, reliable access to corporate information—at any frequency—is a relatively new concept. Until the early 1930s, investors often had to travel to a company’s headquarters to see its financial reports at all. Even then, they might be refused if they didn’t already own the stock. In 1974, a survey of more than 400 of the largest U.S. public companies by Information for Business, a financial-research firm, found that 20% wouldn’t provide copies of their annual reports free of charge to investors.

Prof. Harvey and his colleague Itzhak Ben-David, a finance professor at Ohio State University, have an even more-drastic idea: Companies should update their basic financial information—assets and liabilities, revenues and expenses—daily or even in real time. Firms wouldn't have to disclose anything they don't already list in their annual or quarterly reports, so competitors couldn't take advantage of their real-time disclosures. But such continuous updates would “decrease the possibility of misinformation and value distortion,” says Prof. Harvey.

In the age of big data, such a development seems almost inevitable down the road, even if many companies lack the technology to implement it today.

A simple step the SEC could consider immediately: clarifying that it doesn't require companies to give quarterly guidance. Although only about 27% of public companies do so, “there seems to be a widespread belief, especially among newly public companies, that they have to provide earnings guidance,” says Sarah Keohane Williamson, CEO of FCLTGlobal, a nonprofit consortium of corporations and institutional investors seeking to encourage long-term business thinking.

One thing seems likely: Slowing down the frequency of corporate reporting probably won't keep investors from overreacting to short-term disappointments.

The London stock trader Thomas Mortimer, in his book “Every Man His Own Broker,” wrote that when bad news spreads quickly in the stock market, an investor “has an opportunity of selling at a small loss, four or five per cent.” After longer delays between disclosures, however, “whenever a long concealed misfortune that has happened to any [company] comes to be divulged, or [the company] takes any unexpected measures, the fall on the shares in the stock... may be twenty or thirty per cent in one day.”

In other words, the longer bad news is delayed, the worse the market's response.

Mortimer published his book, one of the earliest known guides to the financial markets for individual investors, in 1765. If companies stop reporting quarterly results, there's no reason to think the outcomes would be much different today.

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