The Impact of Financial Reporting Frequency: Balancing Transparency, Short-Termism, and Regulatory Implications

SM460 - Honors Senior Capstone Project

Faculty Leader: Professor Francois Brochet

Team: Michael Giacchetto, Amanda (Weng In) Lou, Justin Kay, Zachary Cook

Executive Summary

Research Question: What are the benefits and drawbacks of frequent (quarterly) financial reporting, and how does regulation shape its impact?

Key Benefits

- Increased Transparency: Reduces information asymmetry between firms and investors.
- Lower Cost of Capital: Investors demand lower risk premiums when they have timely, reliable information.
- Improved Market Efficiency: Narrows the information gap between sophisticated and average investors.
- Enhanced Credit Risk Management: Banks and credit agencies can better assess firm risk with more frequent data.
- Greater Forecast Accuracy: Financial analysts provide more accurate earnings projections with quarterly data.

Key Drawbacks

- Managerial Short-Termism: Firms may cut R&D or capital investment to meet near-term earnings targets.
- High Compliance Costs: Smaller firms face disproportionate burdens from frequent reporting mandates.
- Increased Market Volatility: Short-term trading and overreaction to quarterly earnings can destabilize prices.
- Reduced Voluntary Disclosures: Mandatory reporting can discourage firms from offering richer, optional insights.

Glocal Case Studies & Regulatory Evidence

- EU: Shift to quarterly reporting led to earnings management and short-term behavior, reversed in 2013.
- Singapore: Small firms saw a 5% drop in firm value after mandatory quarterly reporting was introduced.
- United States: Historic move from annual to quarterly reporting correlated with reduced long-term investment.

Earnings Guidance Insights

Though not required, earnings guidance helps investors forecast performance.

- *Benefits:* Improves analyst forecast precision and investor expectations
- *Drawbacks:* Can heighten short-term performance pressure on management

Firms that stop issuing guidance attract more long-term investors without increased volatility

Company Example: Google chose not to provide earnings guidance upon going public in 2004, signaling a commitment to long-term value over short-term expectations.

Policy Recommendations

- Consider Hybrid Models: Semi-annual reporting with qualitative interim updates can balance transparency with long-term focus.
- Tailor Regulation: Policy should reflect firm size, industry, and market maturity.
- Avoid One-Size-Fits-All Mandates: Evidence shows varied effects across jurisdictions and firm types.

Conclusion

- Frequent reporting offers clear advantages in transparency and efficiency, but can unintentionally promote short-termism.
- Regulators must balance investor protection with the need to encourage long-term value creation and innovation.

I. Introduction

Financial reporting frequency plays a pivotal role in shaping corporate transparency, influencing investor decision-making, and guiding managerial behavior. As firms and regulators around the world grapple with the appropriate balance, reporting frequency has become a key mechanism for either attracting long-term investors or alleviating compliance burdens. Transparency, investor confidence, and corporate governance are closely tied to how often financial information is disclosed (Filip et al. (2024)). This paper explores the central research question: What are the benefits and drawbacks of frequent (i.e., quarterly) financial reporting, and how does regulation shape its overall impact? To address this, this paper examines theoretical perspectives on reporting frequency, reviews key empirical findings, and considers the broader policy implications of various regulatory approaches.

II. Theoretical Perspectives on Financial Reporting Frequency

A fundamental trade-off between transparency and the risk of short-termism shapes the debate around financial reporting frequency. On one hand, more frequent reporting enhances the flow of information to the market, enabling investors to make better-informed decisions and improving corporate accountability. Gigler et al. (2014) argue that this increased transparency can reduce information asymmetry between managers and investors. For example, studies have shown that firms with higher reporting frequency benefit from lower costs of equity, as investors perceive them to be less risky due to improved access to timely financial data (Houston et al. (2010)). However, this greater transparency may come at a cost, specifically, encouraging managerial behaviors that focus on meeting near-term benchmarks rather than fostering sustainable long-term growth.

From a market discipline perspective, frequent financial disclosures play a crucial role in narrowing the gap between informed and less-informed investors. Fu et al. (2012) suggest that when companies report more often, it limits the information advantage of sophisticated investors as well and fosters a more level playing field. One study analyzing earnings announcement cycles found that higher reporting frequency diminishes the disparity in information access, thereby enhancing overall market discipline and efficiency (Kraft et al. (2018)). In this view, quarterly reporting acts as a governance tool that holds managers accountable and builds trust in capital markets.

Finally, the global regulatory landscape reflects differing priorities when it comes to setting reporting frequency standards. Some jurisdictions emphasize investor protection and transparency, mandating quarterly disclosures, while others seek to reduce corporate compliance burdens, especially for smaller firms. Filip et al. (2024) highlight how these varied approaches embody the ongoing balancing act between ensuring market efficiency and avoiding excessive regulatory pressure on companies. The diversity in global reporting regimes highlights the complexity of finding an optimal standard that fits all market contexts.

III. Benefits of Frequent Financial Reporting

The central debate surrounding financial reporting lies in its frequency. There has been ongoing discussion about whether firms should be mandated to report their financial data on a quarterly or semi-annual basis. Currently, publicly traded firms in the United States are required to report their financial results quarterly.

One of the primary benefits of frequent financial reporting is the reduction of information asymmetry, which can, in turn, lower a firm's cost of capital. According to a paper by Robert Stoumbos (2023), the information gap between sophisticated and average investors is narrower in firms that report their financial data more frequently. This narrowing of the information gap leads to a lower bid-ask spread (the difference between the prices buyers are willing to pay and sellers are willing to accept) and contributes to greater market efficiency. When companies report quarterly, average investors have more timely access to financial information, which helps level the playing field and reduce asymmetries in the market. Stoumbos provides empirical evidence showing that firms shifting from semi-annual to quarterly reporting experienced measurable reductions in bid-ask spreads, which is an indicator of improved transparency and efficiency. As a result, these firms are often able to access capital at a lower cost. Filip et al. (2012) further support this view, noting that frequent reporting can boost investor confidence and reduce the risk premium demanded by investors. When investors are equipped with more current data, they can make better-informed decisions and feel more secure in their investment choices, ultimately reducing the cost of capital required to attract them. Figure 1 presents a conceptual U-shaped relationship between financial reporting frequency and the cost of equity, based on Gigler et al. (2014). It suggests that quarterly reporting minimizes the cost of equity by striking a balance between transparency and the avoidance of excessive short-term pressure.

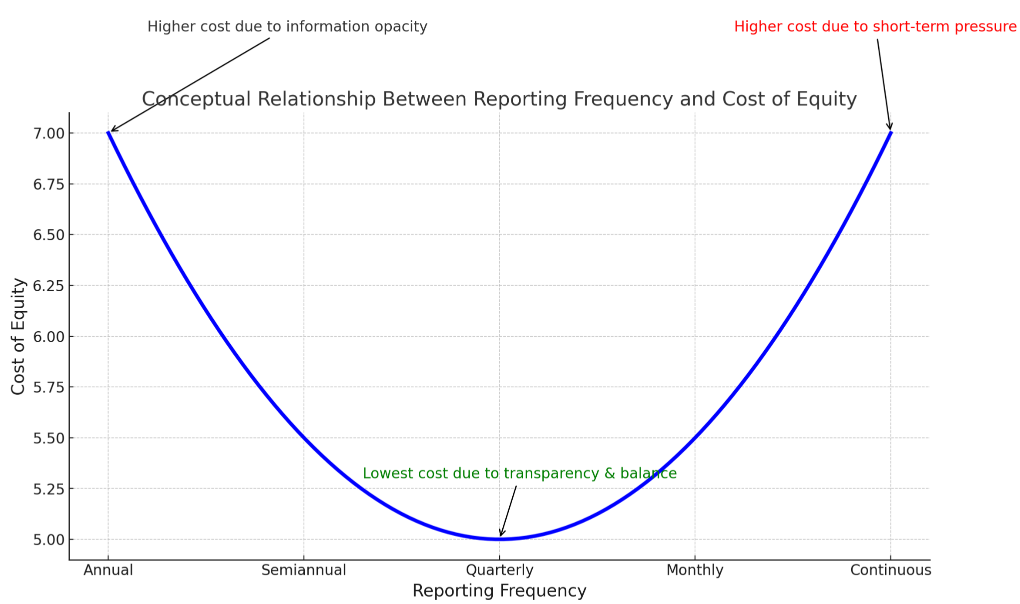

Figure 1: Conceptual Relationship Between Reporting Frequency and Cost of Equity (Gigler et al. (2014))

Another key benefit of quarterly financial reporting is its contribution to improved credit and risk management. A study by Balakrishnan and Ertan (2018) finds that more frequent reporting allows banks and financial institutions to better assess asset quality and credit risk. This leads to lower credit spreads and a reduction in excessive risk-taking. When firms disclose financial data on a quarterly basis, executives, investors, and stakeholders can detect emerging credit risks earlier, enabling them to adjust strategies proactively and mitigate potential losses. Credit agencies and financial institutions also benefit from more timely data, allowing them to make more accurate and informed assessments of a firm's financial health, which is something more difficult to achieve with only semi-annual disclosures.

Lastly, frequent financial reporting enhances the accuracy of financial analysts' forecasts. Filip et al. (2024) demonstrate that quarterly disclosures reduce forecast errors and improve the quality and profitability of stock recommendations, especially in environments where obtaining financial information is costly. With access to more up-to-date information, analysts can create more accurate projections and financial models, which in turn leads to better investment decisions. The study also notes that mandatory quarterly reporting significantly improves the reliability of analysts' recommendations, helping investors navigate markets with greater confidence.

IV. Drawbacks of Frequent Financial Reporting

While frequent financial reporting provides several benefits, it also comes with drawbacks. One of the primary drawbacks of frequent financial reporting is the tendency it creates toward managerial myopia and short-termism. Research indicates that more frequent disclosures lead managers to prioritize short-term earnings targets at the expense of long-term investments. For instance, Kraft et al. (2018) and Gigler et al. (2014) provide evidence that increased reporting frequency is associated with reduced capital expenditures and innovation output. One study highlights that higher reporting frequency leads to a significant decline in R&D intensity, as firms shift focus away from long-term value creation. In fact, analyzing historical U.S. data, researchers observed a substantial reduction in long-term investments following a transition to more frequent reporting intervals. Additionally, firms moving from semi-annual to quarterly reporting demonstrated a marked decrease in capital investment, with little to no positive externalities observed. As one study concludes, while there may be benefits to transparency, increased reporting frequency can induce managerial short-termism and undermine innovation (Stoumbos (2023), Kraft et al. (2018), Ernstberger et al. (2017)).

Another concern lies in the increased compliance costs that frequent reporting imposes, especially on smaller firms. Kajüter et al. (2019) show that smaller companies disproportionately bear the burden of quarterly reporting requirements. While reporting and proprietary costs may be less significant for firms listed on prime markets, smaller or mid-cap firms face a tradeoff. Some studies found that firms that reduced the frequency or content of quarterly reports experienced a decline in market liquidity, although the accuracy of analyst forecasts remained unaffected. Moreover, among EU firms subject to mandatory quarterly reporting, those with less informative interim reports showed higher levels of real earnings manipulation, suggesting that compliance pressure may degrade reporting quality rather than enhance it (Bornemann et al (2023), Ernstberger et al. (2017)).

Frequent financial reporting may also lead to increased market volatility due to potential investor overreaction. When firms release earnings reports more often, short-term trading activity intensifies, which can drive excessive fluctuations in stock prices. Butler et al. (2007) found that increased frequency in reporting can result in unnecessary short-term trading and volatility. For instance, a study on Singapore-listed firms revealed a five percent decline in firm value following the implementation of mandatory quarterly reporting (particularly among smaller firms) indicating that markets may perceive this requirement as a net burden. Additionally, frequent disclosures can encourage behaviors such as "window dressing," where low-skill fund managers make superficial portfolio adjustments to create misleading signals before reporting periods in the mutual fund industry (Kajüter et al. (2019), Filip et al. (2024), Butler et al. (2007)).

Lastly, the emphasis on mandatory frequent reporting may inadvertently reduce voluntary disclosures. When firms are required to issue regular formal updates, they may feel less incentivized to provide supplementary insights that are not mandated, leading to a less informative disclosure environment overall. Gigler and Hemmer (1998) argue that this crowding out of voluntary disclosures can limit the richness and context of financial information available to investors, thereby diminishing the overall transparency such rules aim to promote.

V. Empirical Evidence from Regulatory Changes

To understand how theory plays out in practice, this section draws on regulatory changes in the European Union (EU), Singapore, and the U.S. The EU's experience provides insightful evidence of how regulatory changes in reporting frequency have led to different market outcomes. When the EU transitioned from semi-annual to mandatory quarterly reporting in the early 2000s, empirical studies documented significant unintended consequences. Ernstberger et al. (2017) find that this shift led to increased real earnings management activities, as corporate managers engaged in more myopic behavior to meet short-term targets. Various operational decisions, such as cutting research and development expenditure or delaying maintenance spending, were conducted to boost immediate financial results.

Realizing these detrimental effects, the EU parliament reversed course in 2013 by rejecting a proposal to maintain the requirement for quarterly financial reporting and adopting a "Transparency Directive" (Stoubos, 2023). The new framework only requires interim disclosure instead of a full quarterly financial statement, representing a regulatory shift balancing investor transparency while addressing the market concern on pushing managerial short-termism.

A similar finding emerged from the Singapore regulatory environment. Kajüter et al. (2019) employ regression discontinuity analysis to examine the causal effects of Singapore's introduction of mandatory quarterly reporting. Their study reveals a five percent decline in firm value specifically among small firms following the implementation of quarterly reporting requirements. These persistent valuation efforts suggest that some investors believed the reporting mandate imposed unnecessary net costs, which outweighed the benefit of increased transparency for smaller companies, with compliance burdens outweighing any informational advantages.

Historical evidence from the United States further reinforces these concerns. Kraft et al. (2018) analyze the phased transition from annual to quarterly reporting between 1950-1970, finding that increased reporting frequency correlated with measurable reductions in long-term investments. This multi-decade study provides particularly robust evidence that quarterly reporting requirements may systematically reorient corporate priorities toward short-term performance at the expense of value-creating long-term projects. The consistency of these findings across different economic powerhouses and periods strengthens the case for carefully considering the consequences of frequency mandates.

VI. The Role of Earnings Guidance and Its Intersection with Reporting Frequency

So far, we have discussed the pros and cons of mandatory financial reporting frequency. However, firms can supplement these required disclosures with voluntary communications, most notably earnings guidance, which is management's forward-looking estimates of key financial metrics, such as earnings per share (EPS) or revenues, for upcoming periods. Unlike financial reporting, which is mandatory and retrospective, earnings guidance is optional and prospective, offering insights into a firm's expected future performance.

The primary argument for quarterly earnings guidance is that it enhances forecasting accuracy and improves market transparency. Indeed, Earnings guidance plays a critical role in shaping investor expectations and firm valuation. By providing regular updates on expected performance, firms help analysts and investors form more precise earnings estimates, reducing information asymmetry. When companies cease issuing quarterly guidance, analysts face greater difficulty in predicting earnings, leading to increased forecast dispersion and reduced accuracy (Xin et al., 2024). This suggests that guidance is a crucial anchor for market expectations, particularly in industries where earnings are volatile or difficult to model.

However, despite the challenges posed by the absence of quarterly guidance, research indicates that stopping guidance does not significantly affect stock return volatility or the number of analysts covering a firm (Xin et al., 2024). This implies that while the lack of guidance may introduce some uncertainty, markets can process alternatives of information, such as annual reports, management commentary, and industry trends, to maintain relatively stable valuations.

The frequency of guidance, particularly quarterly guidance rather than annual, can influence investor behavior, managerial decision-making, and ultimately, long-term firm performance. Studies show that such firms attract more long-term institutional investors while deterring short-term traders (Kim et al., 2017). This shift affects how earnings information is incorporated into firm valuation, where investors place greater weight on long-term performance rather than short-term earnings surprises (Butler et al., 2007).

<u>Managerial Responses to Guidance Stoppage</u>

The decision to stop providing quarterly guidance may influence managerial behavior in different ways. While some research suggests it allows firms to focus more on sustainable growth (Kim et al., 2017), others find no significant change in investment patterns (Houston et al., 2010; Chen et al., 2011). This variation likely depends on firm-specific factors, including persistent market pressures, industry dynamics, and whether companies implement complementary long-term strategies beyond just stopping guidance.

A related concern is that frequent financial reporting requirements may inadvertently encourage short-termism. Bornemann et al. (2023) find that higher reporting frequency can lead to real activities manipulation, particularly when investor price pressure is high or when interim disclosures lack informativeness. This suggests that frequent reporting, combined with earnings guidance, may amplify managerial focus on short-term performance at the expense of sustainable growth. Notably, firms that stop issuing quarterly guidance experience fewer CEO dismissals due to minor earnings misses (Kim et al., 2017), indicating that reduced short-term earnings pressure allows executives to focus on strategic, long-term objectives rather than meeting narrow quarterly targets. Figure 2, based on findings from FCLTGlobal and NIRI, illustrates a clear downward trend in the percentage of S&P 500 companies providing quarterly EPS guidance (declining from nearly 50% in 2004 to just 21% in 2024), highlighting a broader shift away from short-term forecasting practices over the past two decades.

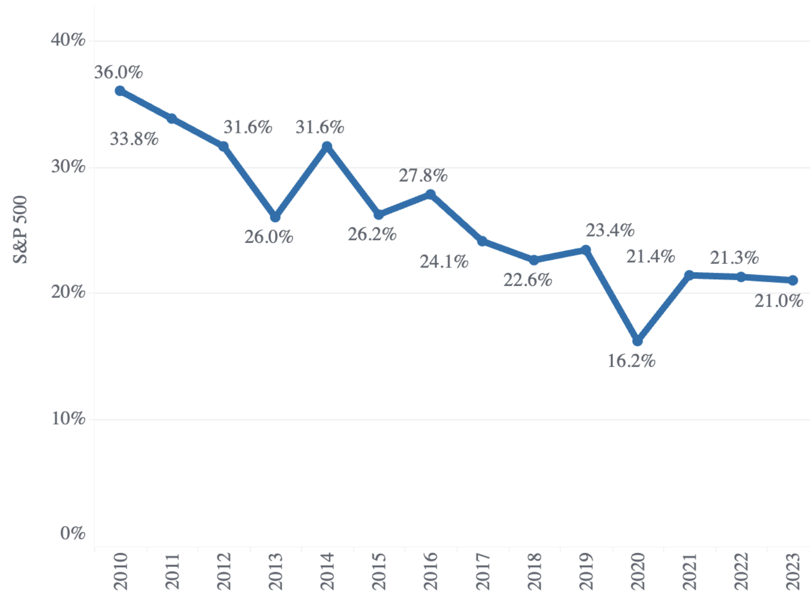

Figure 2: Percentage of S&P 500 Companies Offering Quarterly EPS Guidance (FCLTGlobal)

Company Example: Google's Decision to Withhold Earnings Guidance
A notable example of a company rejecting quarterly earnings guidance is Google (now Alphabet Inc.). When the company went public in 2004, its executives made a deliberate decision not to provide earnings guidance, which was a move that broke from the standard practice of many public firms at the time. In its IPO letter to shareholders, Google emphasized its commitment to long-term value creation over short-term earnings targets, stating that frequent guidance could lead to an unhealthy focus on short-term performance at the expense of innovation and strategic growth. Despite initial skepticism from analysts and investors, Google's stance has been largely validated over time, as the company maintained strong capital market access, attracted long-term institutional investors, and sustained its reputation for innovation and financial performance.

VI. Policy Implications and Future Research Directions

Policymakers should rigorously evaluate the broader consequences of frequent financial reporting mandates. Frequent reporting requirements, while intended to improve transparency, may paradoxically foster conditions to promote short-termism in investment strategies and real earnings manipulations. This dynamic creates an environment where managers may prioritize meeting short-term earnings expectations at the expense of sustainable long-term value creation.

Empirical findings indicate that firms discontinuing quarterly earnings guidance experience a notable shift in their investor composition toward a higher proportion of long-term institutional investors, who typically place greater emphasis on sustainable, long-term financial performance metrics (Butler et al., 2007; Kim et al., 2017). This shift suggests potential benefits associated with reducing the frequency of earnings guidance, as firms might then be less incentivized to manage short-term earnings targets at the expense of strategic long-term investments. However, policymakers must also recognize the trade-offs inherent in guidance cessation. Firms discontinuing guidance commonly face challenges such as increased analyst forecast dispersion and reduced forecast accuracy, though notably without an accompanying rise in return volatility or diminished analyst coverage (Xin et al., 2024).

A potential policy avenue to explore involves transitioning to semi-annual financial reporting, complemented by mandatory qualitative updates during interim periods. Drawing insights from past regulatory shifts, such as the 2004 SEC mandate that increased reporting frequency for mutual fund holdings, it becomes evident that while enhanced transparency can yield certain advantages, it concurrently amplifies the risks of practices like window dressing and performance manipulation. Therefore, policymakers must carefully calibrate the desire for transparency against the potential for unintended negative consequences arising from increased reporting frequency when designing regulatory frameworks.

VII. Conclusion

This paper explores the trade-offs between transparency and short-termism in the context of financial reporting frequency. While more frequent financial disclosures enhance transparency for investors, stakeholders, and decision-makers, they can also encourage short-term thinking. Managers may become overly focused on meeting immediate targets rather than prioritizing the long-term growth and sustainability of their firms. We also highlight the significant benefits of frequent financial reporting, such as increased investor confidence, lower cost of capital, and a reduction in information asymmetry.

Although the advantages of frequent reporting are substantial, this paper also discusses its notable drawbacks. These include a greater tendency toward managerial myopia and short-termism, disproportionately high compliance costs for smaller firms, increased market volatility due to investor overreactions, and a possible reduction in voluntary disclosures as firms may feel less incentivized to share non-mandated information.

We examine global case studies from Europe, Singapore, and the United States, showing how the shift from semi-annual to quarterly reporting has led to unintended consequences such as declines in firm value, increased earnings management, and a stronger emphasis on short-term performance. At the same time, we explore how quarterly reporting guidance can improve forecasting accuracy and market transparency. Interestingly, despite the absence of such guidance in some contexts, research finds no direct correlation between reduced reporting frequency and increased stock volatility.

Ultimately, the frequency of financial reporting introduces a paradigm shift in corporate behavior and investor perception. Policymakers must weigh both the benefits and the downsides when determining reporting requirements. While more frequent reporting reduces information asymmetry, lowers the cost of capital, and improves forecast accuracy, it may also unintentionally promote short-termism, earnings management, and the neglect of long-term strategic goals. Thus, it is crucial to strike a balance that captures the advantages of both approaches.

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