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SMU Assistant Professor Kim Jae Bum studies how decisions on voluntary disclosures are made by company managers.

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AsianScientist (Jul. 9, 2015) - By David Turner - In this age of social media, we broadcast more news about our daily lives than we ever imagined we would. But imagine if you had to continually choose whether or not to publish your work performance—whether you had fulfilled your promises and, more interestingly, why you had succeeded or failed.

This is the dilemma faced by company managers—to disclose or not to disclose information about their company's performance and expectations. Going beyond compulsory disclosures such as regulatory filings and financial statements, the information conveyed by voluntary disclosures such as predictions of earnings performance for the next quarter or year directly influence share prices.

Uncovering the motivations behind these voluntary disclosures is the research interest of Assistant Professor Kim Jae Bum at the Singapore Management University (SMU) School of Accountancy. He says that company managers are economic agents who react to their incentives and prefer to publish the good news and hold back the bad news.

Voluntary but strategic

Yet also significant are the external factors that override the management's inclinations, says Professor Kim.

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“I am interested in how voluntary disclosure is influenced by the surrounding environment, such as the institutional factors that lead company managers to disclose high quality information.”

In theory, these factors should be arranged so that what is good for the company is also good for the manager, and Professor Kim’s current research shows how this can work in practice.

“Linking manager compensation to the long term horizon leads to more disclosures because it aligns the company manager’s interests with those of shareholders, and the long term results mitigate the impact of short term bad news on the manager,” he says.

Even taking this into account, disclosure decisions are not straightforward, notes Professor Kim.

“There is always a trade-off. While fuller disclosure can lead to higher stock valuations due to decreased information asymmetry, it can also lead to loss of competitive information, and there is always the danger of litigation resulting from overly optimistic information.”

If company managers are subject to such conflicting forces, why are they allowed much leeway about when and what to disclose? Professor Kim’s view is that managers have some degree of discretion.

“The directors set the parameters as part of their corporate governance policy but, within that, managers make important decisions. Some will give earnings predictions within a wider range than others, and they must also decide on the timing and the format of the disclosure."

Professor Kim’s findings show the extent to which voluntary disclosures are also based on finely calculated decisions. In one recent study, he found that managers even take into account the reputation of particular analysts following their firms. The more reputable the analysts are, the more likely that management will publish quarterly management earnings forecasts. Even the “so-called" reputable analyst’s level of optimism is taken into consideration when disclosing information.

The credit default swap market

To examine what else might force company managers to improve their disclosures, even at the risk of harming their own personal prospects, Professor Kim examined the impact of a market which is recently subject to much criticism—the credit default swap (CDS) market.

One of the financial instruments blamed for the 2008 financial crisis, a CDS is a form of insurance that helps lenders manage the risk of debtors defaulting on loans. The lender makes regular payments to a third party—the CDS seller—and if the debtor defaults, the CDS seller pays out the lender and becomes the owner of the defaulted loan.

“Many people view the CDS market negatively because it is vulnerable to insider trading and it creates systemic risks by reducing the incentive on lenders to monitor their credit risks,” says Professor Kim, but he believes that we should look at the potential positive effects as well.

“CDS prices are determined by informed risk-takers, so analysts and shareholders can use the information conveyed by the CDS prices as a reality check on the risks reported by company managers.”

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Professor Kim and his colleagues surmised that the availability of this yardstick would force managers to improve their disclosures, and this was borne out by their research findings. In a study on US public companies, they found that managers were indeed more likely to issue earnings forecasts and perform forecasts more frequently when their firms are actively traded in the CDS market.

“The CDS market disciplined managers to disclose bad news; even if this could affect their remuneration and career,” he says.

Disclosing in a social media age

Professor Kim says research into voluntary disclosures is entering some exciting fields.

“Disclosure is moving into new mediums that give us new data with more detail—Twitter, Short Messaging Service (SMS), the text of conference calls. Even search engine results are disclosures that influence the market,” he points out.

The insatiable thirst for continuous news feeds has brought an avalanche of data for researchers like Professor Kim to study.

“With this data we can even use linguistic tools to study the language and text of disclosures—for example, are the words negative or positive. We can then understand the implications of this language.”

Optimising voluntary disclosures will help meet the increasing demand for continuous disclosure, he says.

“We need to help the market understand the trade-offs, and the complicated interactions between managers, analysts and the market.”

He hopes that his research will help market participants to better understand firms’ voluntary disclosures and also make it easier for company managers to make the right choices, even if their every word is subject to detailed analysis.

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