

lakyara vol.290

Quarterly financial reporting and management short-termism

Sadakazu Osaki

10.October.2018

Executive Summary



Sadakazu Osaki

Head of Research

Center for Strategic
Management &
Innovation

US President Trump recently tweeted in favor of allowing companies to report earnings semiannually instead of quarterly. Quarterly financial reporting is often criticized for encouraging short-termism among investors and corporate executives but empirical research conducted in the UK found no evidence substantiating such criticism. Regulators considering revising or discontinuing quarterly financial reporting should proceed cautiously without falling under the sway of specious arguments.

.....

Trump's tweet

US President Donald Trump recently captured markets' attention with a tweet in favor of semiannual instead of quarterly reporting of corporate earnings. In the tweet, Trump said he had asked the SEC to look into making such a change in the financial reporting cycle. In response, SEC Chairman Jay Clayton said the SEC "continues to study public company reporting requirements" while acknowledging that Trump had "highlighted a key consideration."

Trump's tweet said in part, "In speaking with some of the world's top business leaders I asked what it is that would make business (jobs) even better in the U.S. 'Stop quarterly reporting & go to a six month system,' said one." The individual who reportedly made the suggestion admitted to having raised the issue with Trump. She explained she had made the comment in the context of "how to better orient corporations to have a more long-term view" and had also suggested exploring harmonization of the US and European systems of financial reporting.

Quarterly financial reporting in Europe and Japan

In the US, mandatory quarterly financial reporting dates back to the Securities Exchange Act of 1934 enacted amid the Great Depression (see table), excluding a 15-year period (1955-70) during which the SEC switched from quarterly to semiannual reporting. The forms on which companies file disclosures are dictated by SEC regulations. Form 10-Q is currently used for mandatory quarterly reports and has been since 1970.

In Europe, by contrast, there is deep-seated resistance to quarterly financial

reporting on the grounds that it not only increases listed companies' costs but also encourages short-termism among investors and corporate executives. The European Commission, the EU's executive arm, sought to mandate quarterly financial reporting throughout the EU in recognition of capital market globalization. However, when the EU's Transparency Directive of 2004 was issued, it did not include a quarterly reporting requirement. Moreover, a 2013 amendment of the Transparency Directive added a prohibition against requiring periodic financial reporting more frequently than semiannually.

EU-member countries consequently do not legally require quarterly financial reporting at the national level, although some European exchanges such as the Deutsche Börse Group's Prime Standard market have adopted their own quarterly financial reporting rules.

In Japan, the Tokyo Stock Exchange (TSE) initially required quarterly financial reporting only for companies listed on its Mothers Market for early-stage companies, largely in response to increasingly rapid change in such companies' operating environment. The TSE subsequently expanded the scope its quarterly reporting requirement to cover companies listed on other markets. In 2006, the government enacted the Financial Instruments and Exchange Act, which mandated quarterly reporting for all listed companies, in response to corporate lobbying for uniform accounting and auditing standards.

Securities exchanges have since relaxed and simplified their rules on quarterly earnings disclosures' content in response to complaints about the double burden of preparing such disclosures in addition to statutorily required quarterly reports,

Quarterly financial reporting in Japan, US and Europe

US	<ul style="list-style-type: none"> • Quarterly financial reporting required of listed companies pursuant to Securities Exchange Act of 1934. • SEC regulations require companies to file quarterly reports using Form 10-Q within 40-45 days of quarter-end (filing deadlines differ based on company's market cap).
Europe	<ul style="list-style-type: none"> • EU's Transparency Directive of 2004 required companies to file Interim Management Statements (IMS) semiannually between the 10th and 19th week of every semiannual period, but the EU refrained from officially adopting quarterly reporting. • Amended Transparency Directive of 2013 eliminated IMS filing requirement and prohibited countries from requiring financial reporting more frequently than annually or semiannually. • EU Directive's prohibition applies to national laws but some securities exchanges have set rules requiring quarterly reporting.
Japan	<ul style="list-style-type: none"> • TSE imposed quarterly financial reporting requirement on its Mothers Market in 1999 and extended the requirement to other markets in phases from 2003. • Quarterly reporting was mandated (effective from 2008) by 2006 Financial Instruments and Exchange Act. • In 2017, TSE relaxed its rules for earnings disclosures, including quarterly ones, to facilitate timely disclosure, lessen listed companies' administrative burden and grant more flexibility in terms of disclosures' format.

Source: NRI, based on information from various sources

but quarterly reporting is currently still required.

No evidence that quarterly reporting promotes short-termism

There is no denying that companies incur costs to prepare quarterly financial statements and have them reviewed (but not necessarily audited) by an independent auditor. However, companies should be willing to bear reasonable costs in exchange for the benefit of a stock market listing, including access to funding from a broad range of investors and utilization of stock-based compensation plans. Meanwhile, many investors are opposed to discontinuing quarterly financial reporting because they believe a reduction in the frequency of information disclosure would leave them with less information of value to their investment decisions.

Before Trump's tweet, JPMorgan Chase CEO Jamie Dimon and the renowned investor Warren Buffett, the "Sage of Omaha," recently made news in the US by calling for an end to quarterly earnings guidance on the grounds that it exacerbates management short-termism. However, they want to preserve quarterly financial reporting itself as an essential ingredient of continued market transparency.

The notion that quarterly reporting is conducive to short-termism among investors and corporate executives is not well-founded to begin with. In the US, the current system of quarterly financial reporting has been in existence for nearly 50 years. Given the US economy's dramatic growth and development over that time span, it is utterly inconceivable that US companies have been locked into a short-term management mindset the whole time.

Additionally, while the EU's financial reporting regime was evolving as described above, the UK imposed a quarterly reporting requirement on listed companies in 2007. The requirement remained in effect for seven years only. A research study investigated whether there was any change in companies' investments from a long-term perspective between before and after quarterly reporting was adopted or before and after it was discontinued. The study found no significant changes.

With ESG investing attracting growing interest in recent years, some investors are clamoring for greater disclosure of nonfinancial information. Merely increasing the amount of information subject to disclosure will only impose more costs on listed companies. I suspect that quite a few corporate CEOs would like to discontinue

quarterly financial reporting. Even so, regulators should proceed cautiously with revising or eliminating quarterly reporting requirements, carefully weighing the costs and benefits of doing so. They must not fall under the sway of specious arguments.

about NRI

Founded in 1965, Nomura Research Institute (NRI) is a leading global provider of system solutions and consulting services with annual sales above \$4.4 billion. NRI offers clients holistic support of all aspects of operations from back- to front-office, with NRI's research expertise and innovative solutions as well as understanding of operational challenges faced by financial services firms. The clients include broker-dealers, asset managers, banks and insurance providers. NRI has its offices globally including New York, London, Tokyo, Hong Kong and Singapore, and over 13,000 employees.

For more information, visit <http://www.nri.com/global/>

.....

The entire content of this report is subject to copyright with all rights reserved.
The report is provided solely for informational purposes for our UK and USA readers and is not to be construed as providing advice, recommendations, endorsements, representations or warranties of any kind whatsoever.
Whilst every effort has been taken to ensure the accuracy of the information, NRI shall have no liability for any loss or damage arising directly or indirectly from the use of the information contained in this report.
Reproduction in whole or in part use for any public purpose is permitted only with the prior written approval of Nomura Research Institute, Ltd.

Inquiries to : Financial Market & Innovation Research Department
Nomura Research Institute, Ltd.
Otemachi Financial City Grand Cube,
1-9-2 Otemachi, Chiyoda-ku, Tokyo 100-0004, Japan
E-mail : kyara@nri.co.jp

<http://www.nri.com/global/opinion/lakyara/index>

.....