

Consistent Expectation Management Patterns and Market Reactions to Earnings Announcements

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This study examines how market participants react to the expectation management behavior of firms, especially when the firms demonstrate consistent patterns of expectation management. Expectation management generally refers to cases where managers provide pessimistic earnings guidance to analysts, followed by a positive earnings surprise at the earnings announcement. Using management guidance data to identify expectation management firm-quarters, I find that the market rewards firms that manage earnings expectations. I also find that there is an incremental reward to firms that consistently manage earnings expectations. This indicates that the more frequent a firm successfully manages earnings expectations, the more favorable the market reaction to its earnings announcements. Furthermore, the reward cannot be explained by the firm's consistently beating/meeting earnings. The initial results show that, conditional on beating the earnings target, the market reward to consistent expectation management firms is higher than that to the corresponding non-expectation management firms. This suggests that previously documented market rewards to beating/meeting earnings targets may be at least partially driven by the firms that manage expectations successfully. I propose and discuss alternative explanations to why the market rewards expectation management, such as firms that manage expectations successfully have strong management expertise and/or conservative financial disclosure practice.