

DISCLOSURE BIASES IN PROXY PERFORMANCE GRAPHS: THE INFLUENCE OF PERFORMANCE AND COMPENSATION COMMITTEE COMPOSITION

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ABSTRACT

Recent research suggests that firms exercise discretion in financial disclosures beyond earnings management and that insider directors are favorably biased toward the CEO. We investigate whether proxy statement disclosures differ systematically across firms with respect to the disclosure of common stock return performance comparisons. Our results are consistent with the assertion that relative return performance and the presence of insider directors on the compensation committee are factors in the decision to fully disclose cumulative return information. We find that the likelihood that firms fully disclose cumulative return information on the performance graph varies positively with their 1992 performance relative to the industry benchmark return. We also find that firms with at least one insider director on the compensation committee differ from other firms in their performance graph reporting practices. Such firms are less likely to provide full disclosure when the firm's relative performance is negative. Further, firms with at least one insider director on the compensation committee display greater downward bias in their self-selected industry benchmark returns. This is the first paper that we are aware of to find results consistent with the assertion that the composition of the compensation committee, in terms of insiders and outsiders, influences reporting practices. Taken as a whole, our findings suggest that reporting discretion was exercised for management's benefit.