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CONCEALMENT OF NEGATIVE ORGANIZATIONAL OUTCOMES: AN AGENCY THEORY PERSPECTIVE

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To explore if, when, and how intentionally corporate officers conceal negative organizational outcomes from shareholders, we used computer-assisted content analysis of over 1,000 president's letters contained in annual reports to shareholders. Results suggest that outside directors, large institutional investors, and accountants limit such concealment, but small institutional investors and outside directors who are shareholders prompt it. Low disclosure is associated with subsequent selling of stock by top officers and outside directors. This result supports the claim that concealment by officers and its toleration by outside directors may be intentional.

Do corporations' officers favor their own interests over those of shareholders? A variety of organizational scientists, working from different theoretical perspectives, have converged on the same answer: when shareholders, or those acting on their behalf, lack the motivation or ability to verify whose interests corporate officers are serving, officers tend to favor their own interests over shareholders' (Eisenhardt, 1989; Pfeffer, 1981).

Empirical evidence suggests that when difficulties beset corporations, their officers direct either or both of two self-interested communication strategies at uninformed shareholders. First, officers interpret the negative outcomes that they do reveal to shareholders in ways that shift the blame for those outcomes away from themselves. A number of large-sample studies of letters to shareholders from corporate presidents included in annual reports have revealed, for example, that officers attribute negative organizational outcomes to uncontrollable environmental causes and positive outcomes to their own actions (Bettman & Weitz, 1983; Bowman, 1976; Salancik & Meindl, 1984; Staw, McKechnie, & Puffer, 1983). Second, officers may conceal negative outcomes entirely. Here, empirical evidence is more preliminary. Case studies of organizations in crisis have revealed examples of concealment by corporate officers (Starbuck, Greve, & Hedberg, 1978; Sutton & Calahan, 1987). Little large-sample evidence exists, however, supporting the

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claim that corporate officers tend to intentionally conceal negative outcomes from uninformed shareholders.

This study began to fill this research gap using a computer-assisted content analysis technique to examine corporate officers' communications to shareholders in over 1,000 president's letters. We used agency theory to explore three questions of concern not only to organizational scientists studying corporate officers' self-interested behaviors, but also to individuals and institutions that either invest in corporations, manage such investments, or regulate corporate officers' communications to shareholders. First, do corporate officers conceal negative organizational outcomes in their communications to shareholders? Second, if officers do conceal negative outcomes, when do they do so? Third, does such concealment occur intentionally, in the course of a conscious communication strategy, or unintentionally, in the course of officers' concealing outcomes that threaten their self-esteem, not only from shareholders, but from themselves as well?

We argue that certain types of shareholders and directors may have the motivation, skill, and knowledge to forestall such concealment, as may accountants. Our central thesis was that by studying the effects of such individuals on officers' communications to shareholders through presidents' letters, we could establish both if and when corporate officers tended to conceal negative organizational outcomes. If we found that certain shareholders and directors, or accountants, tended to force disclosure of organizational problems, we would have some evidence of officers' concealing negative outcomes *when* they were not forced to disclose them. Likewise, if we found that concealment was associated with subsequent short-term stock selling by these officers, we would have some evidence of intentionality (Staw et al., 1983).

THEORY

Scholars who theorize about the management of information, symbols, and impressions by corporate officers have argued that when shareholders' impressions are open to interpretation, officers use communication strategies that favor their own interests (Pfeffer, 1981). A number of scholars have discussed what we call a concealment strategy (Sutton & Calahan, 1987). Pfeffer claimed that corporate officers can avoid assessments by "keeping secret the information that might be necessary or useful for evaluating organizational results" (1981: 30). Ashforth and Gibbs described the "suppression of information regarding activities or outcomes likely to undermine legitimacy" (1990: 180). Whetten stated that "in some cases business managers deliberately hide negative financial data so as not to alarm stockholders and bankers" (1980: 162).

Anecdotal evidence (Argenti, 1986: 45–46, 140–146) and a number of case studies of organizations in crisis have described instances in which corporate officers concealed negative organizational outcomes. Starbuck,

Greve, and Hedberg's study of a company in crisis led them to observe that "managers launch propaganda campaigns that deny the existence of crises" (1978: 118). Sutton and Calahan (1987) noted that certain officers of companies filing for chapter 11 bankruptcy concealed their firms' failures. No large-sample field evidence exists, however, that indicates if and when officers conceal negative outcomes from uninformed shareholders. Nor is it clear from these case studies whether corporate officers have concealed intentionally or unintentionally (Staw et al., 1983).

Motives for Concealment

Agency theorists have noted that in the corporate form of organization, shareholders contract out control over an organization's daily operations to corporate officers (Berle & Means, 1932). This separation of ownership by shareholders (the principals) from control by officers (the agents) can create agency problems. One such problem occurs when (1) conflicts of interest arise—agents and principals have different interests—and (2) information asymmetries arise: principals do not control the information necessary to verify that agents are acting in the principals' interests (Eisenhardt, 1989). Agency theorists assume that under these conditions, agents are opportunists, favoring their interests over the principals' interests. The interests of shareholders, for instance, may dictate that projects generating negative outcomes be terminated. The interests of the officers managing these projects may, however, dictate that they pursue these projects in the hope of turning them around and preserving their own reputations as project managers. A laboratory study suggested that in the face of such conflicting interests, subjects put in the position of officers decide to continue failing projects only if they perceive an information asymmetry between themselves and shareholders, wherein the latter do not have access to information about the project's anticipated outcomes (Harrison & Harrell, 1993).

Conflicts of interest, information asymmetries, and concealment by corporate officers can arise when negative organizational outcomes occur. Information asymmetries occur because officers' involvement in daily organizational operations gives them, and not shareholders, privileged access to information concerning these negative outcomes (Eisenhardt, 1989). Conflicts of interests occur because the interests of officers and shareholders diverge with respect to the revelation of these negative outcomes. It is necessary to compare shareholders' and officers' interests to see why they conflict and why these conflicts might cause officers to conceal negative organizational outcomes.

For two reasons, it is in the interest of shareholders to see negative organizational outcomes revealed. First, if these outcomes are revealed, members of a firm's board of directors can act in the shareholders' interest. Directors can make an informed decision to adjust the incentive contracts of officers to motivate improvement in their performance or decide to replace the officers outright because they are unqualified (Jensen & Murphy, 1990;

Walsh & Seward, 1990). Second, if negative outcomes are revealed, shareholders can make informed decisions about whether or not to sell their shares.

There are two reasons, parallel to the two stated above, why it is not in the interest of corporate officers to reveal negative organizational outcomes. First, officers may not want certain directors to become aware of these outcomes, because they might alter the incentive contracts of the officers or dismiss them. Moreover, officers who reveal negative outcomes damage their reputations, making postdismissal employment more difficult to obtain (Harrison & Harrell, 1993). Second, officers may perceive that if they reveal negative outcomes, shareholders will sell their shares, causing their firm's value to fall. Officers perceive that a lower share value can render their corporation vulnerable to raiders seeking to take control (Fama, 1980; Fama & Jensen, 1983; Jensen & Meckling, 1976). Put differently, officers generally believe, despite recent evidence to the contrary (Walsh & Kosnik, 1993), that if an organization's stock market value falls below what the organization would be worth if it were well managed or if its assets were sold off, it becomes an attractive target for a takeover that would unseat incumbent officers. Lower share value will also reduce the officers' net wealth if they own shares in the organization.

Agency theorists assume that corporate officers pursue their self-interest with guile (Eisenhardt, 1989). Officers should tend, therefore, to conceal negative organizational outcomes, in the hope that they will either not have to disclose these negative outcomes during their planned tenures or can eliminate them before they become apparent to shareholders (Eisenhardt, 1989; Harrison & Harrell, 1993; Walsh & Seward, 1990). Therefore, if it is in officers' own interests to conceal negative organizational outcomes, they should act opportunistically and do so, unless shareholders, directors, or accountants pressure them to reveal the outcomes.

Shareholders. Two different types of shareholders exert contradictory pressures on corporate officers. The first type exerts pressure on officers to disclose negative organizational outcomes. These shareholders are motivated to monitor officers' disclosures closely and can detect concealment and punish officers by bringing shareholder law suits (Galen, 1989). The threat posed by their capability constitutes a potent pressure for revelation.

The second type of shareholder, however, may not be motivated to monitor officers' disclosures closely or may lack the ability to detect concealment and punish officers. These shareholders may unwittingly prompt officers to conceal negative organizational outcomes. This is because, as we argued above, officers may see that if they disclose negative outcomes to these shareholders, they will sell their shares, causing the value of the organization to drop, making it an attractive takeover target and possibly reducing the officers' net wealth. Moreover, officers who disclose negative outcomes eliminate the possibility of reversing these outcomes before they surface or of concealing them during their planned tenures.

Directors. Directors have a fiduciary duty to force the disclosure of

negative organizational outcomes. Directors have a duty to "audit [corporate officers'] performance [and] to see that proper reports are given to stockholders" (Conference Board, 1967: 2). A firm's board of directors can carry out this mandate in two ways.

First, directors who are motivated to monitor disclosures closely and who have the knowledge to do so may be able to detect concealment in reports to shareholders prior to their release on the basis of what they know to be true about an organization and its environment. Agency theorists have generally assumed that inside directors' dual role, as both corporate officers and directors, tends to reduce their motivation to favor shareholders' interests over their own (e.g., Kosnik, 1990). Research indicates, for instance, that CEOs of poorly performing firms are dismissed less often the greater the percentage of inside directors on their boards (Coughlan & Schmidt, 1985; Warner, Watt, & Wruck, 1988; Weisbach, 1988). Conversely, outside directors should be more motivated than insiders to limit concealment (though they are probably less able to detect it) by virtue of the fact that they are not themselves managing the corporation and are, therefore, less knowledgeable about what managers may be concealing (Baysinger & Hoskisson, 1990).

Second, outside directors may also be able to prompt the disclosure of negative outcomes because, if negative organizational outcomes that officers did not disclose surface, it may become apparent to the outsiders that the officers must have known about the problems and should have disclosed them in reports to shareholders. The threat that motivated directors will recognize concealment, either before or after disclosure, and punish opportunistic officers is a potent pressure on officers to reveal negative organizational outcomes.

Accountants. Certain agency theorists have recognized the possibility that accountants, by virtue of their expertise in reviewing financial statements, can reduce information asymmetries between shareholders and managers, thereby forcing managers to disclose negative organizational outcomes (Antle, 1982; Baiman, 1990; Baiman, Evans, & Noel, 1987). This assumption seems eminently reasonable, given that section 15d of the Securities and Exchange Act of 1934 requires that disclosures of financial performance be audited by professional accountants as a safeguard against the concealment of organizational performance. When accountants find a company's financial statements completely consistent with generally accepted accounting standards, they issue an "unqualified" opinion of the company's condition. When, however, they find that they must discuss nonadherence to accounting standards in certain aspects of a company's financial statements, they issue a "qualified" opinion. Under these circumstances, what the organization reports comes under greater scrutiny by shareholders and other constituents. This greater scrutiny may limit officers' use of concealment strategies.

President's Letters to Shareholders

Some previous research has examined officers' communication strategies in president's letters, and this study builds on and contributes to that

stream of research (Bettman & Weitz, 1983; Bowman, 1976; Salancik & Meindl, 1984; Staw et al., 1983). There are two additional reasons why we analyzed president's letters. First, studies have indicated that annual reports to shareholders and their president's letters, in particular, are important vehicles for communicating information to shareholders and other interested stakeholders. Most corporate officers see annual reports as their primary communication channel to shareholders (Goodman, 1980). This perception seems well founded. The income statement contained in such a report has the most influence on investment decisions, but the president's letter is the most widely read part of the document (Courtis, 1982; Lee & Tweedie, 1975). Moreover, a Securities and Exchange Commission (SEC) survey found that 91 percent of respondents acknowledged reading annual reports, that 77 percent reported reading the president's letter at least "somewhat thoroughly," and that 74 percent stated it was at least "moderately useful" for information purposes (House Committee on Interstate and Foreign Commerce, 1977: 287). Finally, evidence indicates that the content of annual reports has an impact on stockholders' investment decisions. Staw and colleagues found that "self-serving attributions [in president's letters] appeared to be convincing to the investing public, since the use of these attributions was associated with subsequent improvement in stock price" (1983: 582). Buhner and Moller stated that their results suggested that "stock market reactions coincide with the annual corporate report announcements of changeover to multidivisional structure" (1985: 309) in president's letters.

Second, legal restrictions leave officers relatively free to shape the textual parts of annual reports, and president's letters therefore provide a window onto the use of communication strategies by officers. As was pointed out above, the SEC enforces section 15d of the Securities and Exchange Act of 1934 requiring audits of financial information. Section 15d also governs textual disclosures, not allowing officers to make "any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." In practice, however, the language of an annual report is less constrained than its financial information because the applicability of section 15d to the textual portion is ambiguous (personal communication from SEC attorney).

HYPOTHESES

In summary, we have argued that corporate officers know that if they disclose negative organizational outcomes, their firms' boards of directors may dismiss them or renegotiate their incentive contracts and the firms may become targets of takeover attempts. Self-interested officers will be motivated to conceal negative outcomes, in the hope that either the outcomes will not surface during their planned tenures or that they can be eliminated before they become apparent. Therefore, officers will tend to conceal negative outcomes unless directors, shareholders, or accountants pressure them to reveal the information.

It is quite a challenge to detect the concealment of negative organizational outcomes by corporate officers because it is difficult to know what negative outcomes an organization has experienced and, therefore, what its officers may be concealing. An organization's financial performance does provide a rough measure of possible negative outcomes besetting it. Indeed, negative organizational outcomes cause poor financial performance, and the Securities and Exchange Commission requires officers to disclose audited financial statements. Therefore, officers tend to reveal poor organizational performance in financial statements. They must then make the content of the president's letter appear consistent with these lackluster financial statements. Officers who report a dramatic drop in their organization's financial performance therefore probably have to discuss this drop in the president's letter as well as some of the difficulties causing it. Thus,

> *Hypothesis 1: The greater the decline in the financial performance of a corporation, the greater the disclosure of negative organizational outcomes in the president's letter contained in its annual report.*

This argument also suggests that, even when performance remains stable for years, officers of organizations with low performance will discuss negative organizational outcomes more extensively than will those of organizations with higher performance.

> *Hypothesis 2: The lower the financial performance of a corporation, the greater the disclosure of negative organizational outcomes in the president's letter contained in its annual report.*

There are three reasons why, even though corporate officers have to disclose their organization's financial performance, they do not have to fully disclose all negative outcomes in the president's letter. First, financial performance itself can be concealed, as recent financial scandals involving ZZZZ best, a carpet-cleaning company, Comtrex, an electronics company, and Lincoln Savings and Loans have illustrated and as the accounting literature on income "smoothing" and distortion has shown (Ronen & Sadan, 1981). Second, even accurate information about financial performance only indicates past negative outcomes. Therefore, officers are still free to hide present and future negative outcomes. Third, financial performance provides only a crude indicator of past negative organizational outcomes. So, even though poorer performers may have to reveal more past negative outcomes in their president's letters than strong performers, they can still conceal some past problems.

The hypotheses below are derived from agency theory and are based on the premise that certain directors and shareholders, as well as accountants, have a greater motivation and ability than others to limit officers' concealment of negative organizational outcomes in president's letters. By ability, we mean both the knowledge to detect concealment and the power to punish it. By motivation, we mean both the motivation to closely scrutinize reports

to shareholders and to punish concealment. We predict generally that, with financial performance controlled, the presence of individuals who can recognize and punish concealment should limit officers' use of concealment strategies and increase revelations of negative organizational outcomes.

Boards of Directors

Boards have a fiduciary duty to audit officers and prompt them to disclose negative organizational outcomes to shareholders. For this reason, a company's board of directors reviews annual reports prior to their disclosure. One writer described their involvement in these terms: "The shareholders' letter bears only one or two signatures, but it is generally a committee project. Public relations staffers or consultants, who often write the first draft, are aware that the copy has to be reviewed by the chief executive officer, the chief financial officer, *the board of directors* and the legal department" (*Wall Street Journal*, 1982: 1; emphasis added). As we noted earlier, agency theorists generally assume that outside directors are more motivated to limit officers' opportunism because outsiders are not themselves officers in the firm on whose board they sit. Outsiders should, therefore, be more effective than insiders in blocking officers' concealment strategies in president's letters, and they should prompt officers to reveal negative organizational outcomes more completely. Thus,

> *Hypothesis 3: The greater the proportion of outside directors on a corporation's board, the greater the disclosure of negative organizational outcomes in the president's letter contained in its annual report.*

Shareholding by Outside Directors

Agency theorists also generally assume that giving outside directors an equity stake in a firm aligns their interests with those of other shareholders. We generally hypothesized, therefore, that outsider-shareholders pressure corporate officers to act in the interests of all shareholders. Research supports this hypothesis in the case of outsider-shareholders' boardroom coalition politics (Miller & Komorita, 1987) as well as their influence on greenmail (Kosnik, 1990) and restructuring decisions (Johnson, Hoskisson, & Hitt, 1993). Likewise, if outsider-shareholders act in shareholders' interests, they may limit officers' use of concealing strategies. Hence,

> *Hypothesis 4: The greater the proportion of a corporation's total shares held by outside directors, the greater the disclosure of negative organizational outcomes in the president's letter contained in its annual report.*

Shareholding by Top Officers

Agency theorists are divided over how share ownership motivates officers. Morck, Shleifer, and Vishny's (1988) convergence-of-interest hypoth-

esis suggests that making officers shareholders causes them and other shareholders to have the same interests (Jensen & Meckling, 1976). This alignment reduces conflicts of interest and causes officers to act in shareholders' interests. High equity ownership by officers has been found to align officers and shareholders' interests in the case of takeovers (Turk, 1992), greenmail decisions (Dann & DeAngelo, 1983; Kosnik, 1990), the adoption of poison pill amendments (Malatesta & Walkling, 1988), and restructurings (Johnson et al., 1993).

Even if corporate officers hold shares in their organizations, however, officer-shareholder conflicts of interests can still arise. Changing the basis on which officers' compensation is calculated or dismissing officers could raise share value. The dismissal of corporate officers is often a form of ritual scapegoating designed to assure organizational stakeholders by attributing poor performance to the dismissed officers rather than to the organization itself (Boeker, 1992; Gamson & Scotch, 1964; Pfeffer & Davis-Blake, 1986). Although such courses of action might be in shareholders' interests, they might not be in these officers' interests. Morck and colleagues' (1988) management entrenchment hypothesis suggests that shareholding by officers allows them to dominate a board, which they seek to do in order to preserve their positions and avoid being scapegoated (cf. Fama & Jensen, 1983). A number of empirical studies have supported this hypothesis, indicating that the chief executive officers (CEOs) and presidents of companies tend to be dismissed less frequently for poor performance the greater the amount of equity they hold (Allen & Panian, 1982; Boeker, 1992; McEachern, 1975; Stulz, 1988). Johnson and colleagues (1993) also concluded that high equity ownership by managers empowered them to forestall board involvement in restructuring decisions.

The management entrenchment hypothesis seems most relevant in this context because conflicts of interest between officers and shareholders over the disclosure of negative organizational outcomes bear on officers' dismissals. The hypothesis suggests that shareholding by officers, if it increases their power, may make them more confident and willing to disclose problems because their power makes it less likely that stakeholders can dismiss them or renegotiate their incentive contracts. Both the alignment-of-interests and management entrenchment hypotheses and supporting research therefore suggest

> *Hypothesis 5: The greater the proportion of a corporation's shares held by its top officers, the greater the disclosure of negative organizational outcomes in the president's letter contained in its annual report.*

It should be noted that Hypothesis 5 focuses on the percentage of shares in a corporation held jointly by its top officers rather than on the percentage of shares held by its CEO. We adopted this focus because, as Finkelstein (1992: 506) indicated, "The limited empirical research comparing explained

variance using the CEO or a wider group of top officers has consistently found that the latter unit of analysis yielded superior results (Bantel & Jackson, 1989; Finkelstein, 1988; Hage & Dewar, 1974; Tushman, Virany, & Romanelli, 1985)." Nonetheless, we also explored the effect on concealment of percentage shareholding by a firm's CEO, or by its president if there was no CEO.

Owner Control

How do powerful shareholders affect the concealment of negative organizational outcomes by corporate officers? A number of studies indicate that when shareholders who are not officers hold as little as 5 percent of a company's equity, they will exert significant control over the company (Gomez-Mejia, Tosi, & Hinkin, 1987; McEachern, 1975; Tosi & Gomez-Mejia, 1989). This 5 percent convention distinguishes owner-controlled firms, in which at least one nonofficer shareholder controls over 5 percent of shares, from management-controlled firms that have no dominant shareholders.

There are at least four reasons why the dominant shareholders of owner-controlled firms may limit officers' uses of concealing strategies. First, because these shareholders hold large blocks of an organization's shares, they cannot easily sell off their holdings for short-term gains (Holderness & Sheehan, 1988). It is in their long-term interest, therefore, to force the disclosure of negative organizational outcomes, so that all stockholders realize that the incentive contracts or composition of top management must be adjusted. Second, because of the greater stake dominant shareholders have in a company, they may monitor officers' disclosures more closely than shareholders with smaller equity stakes (Shleifer & Vishny, 1986). Tosi and Gomez-Mejia (1989) supported this view, finding that the level of monitoring was greater in organizations with dominant shareholders than in organizations with no dominant shareholders. Third, dominant shareholders may be more willing to use their greater power to sue both officers, for making misleading statements of fact, and directors, for allowing such misleading statements (Galen, 1989). Fourth, dominant shareholders may have greater skills to employ in monitoring the information officers disclose. These four arguments suggest that officers of owner-controlled organizations should tend to employ concealing strategies less frequently. Therefore,

> *Hypothesis 6: The disclosure of negative organizational outcomes will be greater in the president's letters of owner-controlled corporations than in the letters of management-controlled corporations.*

Myopic Institutional Investors

Myopic investor theory suggests that institutional fund managers, under strong pressures to maintain high quarterly rates of return on the stock portfolios they manage, have a short-term focus and high risk aversion; they

therefore react to the slightest hint of negative organizational outcomes by selling the organization's stock (Drucker, 1986; Graves, 1988; Hansen & Hill, 1991; Hill, Hitt, & Hoskisson, 1988; Scherer, 1984). Results of research on the myopic investor theory have been mixed, with Graves (1988) finding support whereas Hansen and Hill (1991) did not. If the theory is correct, however, when institutional investors jointly hold large proportions of an organization's shares, the disclosure of negative organizational outcomes may cause "bandwagon" sales of shares by these investors and dramatic dips in the share price (Abrahamson & Rosenkopf, 1993). As a result, the market value of the organization falls below the value of its assets, and officers may perceive that it has become an attractive target for a hostile takeover.

A survey of institutional investors indicated that they use qualitative data, such as president's letters, in addition to quantitative data when making investment decisions (Chugh & Meador, 1984). If myopic investor theory is correct, the threat of disclosing negative organizational outcomes and triggering the sale of shares by jittery institutional investors may place strong pressure on the officers of organizations with large institutional shareholdings to conceal negative organizational outcomes. It follows that

> *Hypothesis 7: The greater the proportion of a corporation's total shares held by institutional investors, the lower the disclosure of negative organizational outcomes in the president's letter contained in its annual report.*

Modified myopic investor theory. Hypotheses 6 and 7 lead to contradictory predictions when organizations are institutional investor–controlled, or have at least one dominant institutional shareholder, who owns at least 5 percent of the firm's shares. Do such dominant institutional shareholders prompt disclosure because they are dominant (Hypothesis 6), or do they limit disclosure because they are institutional shareholders (Hypothesis 7)? We argue the former in the case of dominant institutional shareholders and the latter in the case of nondominant institutional shareholders.

Like dominant noninstitutional shareholders, dominant institutional shareholders cannot move in and out of stocks quickly to gain short-term profits. They should, therefore, behave like any dominant shareholder and force greater disclosure of negative organizational outcomes by corporate officers (Hypothesis 6). Thus,

> *Hypothesis 8: The disclosure of negative organizational outcomes will be greater in the president's letters of institutional investor–controlled corporations than in the letters of other corporations.*

Unlike dominant institutional shareholders, nondominant institutional shareholders (those owning less than 5 percent of a company's shares) can move in and out of stocks easily. Therefore, they should behave as myopic investor theory suggests, reacting to the slightest hint of negative outcomes by selling an organization's stocks. It follows that, when nondominant institutional investors hold a large proportion of an organization's shares, its

officers may feel a strong pressure to conceal negative organizational outcomes in order to avoid triggering such sales.

> *Hypothesis 9: The greater the proportion of a corporation's total shares held by nondominant institutional investors, the lower the disclosure of negative organizational outcomes in the president's letter contained in its annual report.*

Accountants

As we argued above, when accountants find that they must discuss a company's nonadherence to accounting standards, what the organization reports comes under greater scrutiny. This greater scrutiny may pressure management to reveal more negative organizational outcomes in the president's letter. Therefore,

> *Hypothesis 10: There will be a greater disclosure of negative organizational outcomes in the president's letters of organizations receiving qualified audits than in the letters of organizations receiving unqualified audits.*

Intentionality

Agency theories assume that officers intentionally conceal negative organizational outcomes from shareholders. It is possible, however, that officers conceal disagreeable truths from themselves as well—they are genuinely optimistic—and, consequently, unintentionally withhold information from shareholders and directors. Indeed, as psychologists have known for a long time, individuals tend not to seek out information that undermines their positive impressions of themselves and to discount information that does (Zaskind & Costello, 1962). Analyses of president's letters alone cannot allow researchers to distinguish between these two possibilities. Indeed, there is an ongoing debate over whether these letters measure what officers are paying attention to (Clapham & Schwenk, 1991; Huff & Schwenk, 1990) or their use of communication strategies (Salancik & Meindl, 1984; Staw et al., 1983).

Staw and colleagues (1983) developed one way to address the intentionality question. They reasoned that officers who use a communication strategy intentionally, in order to prop up the value of their company's shares, will also tend to sell their shares in the short term, in order to avoid a loss when negative organizational outcomes are disclosed. If they use a communication strategy unintentionally, however, there should be no such sale of shares. Likewise, we hypothesized that, if concealment is intentional,

> *Hypothesis 11: The disclosure of fewer negative organizational outcomes in a corporation's president's letter will be associated with greater subsequent selling of the corporation's stock by its top officers.*

METHODS

All data were drawn from the Compact Disclosure computerized database, produced by Disclosure Incorporated, for March 1989. This database contains information on all publicly owned corporations that have filed a Securities and Exchange Commission document containing financial information in the last 18 months and have at least 500 shareholders and $5 million or more in assets. We examined only organizations in this database that were listed on the New York or American stock exchanges. There were 1,118 such organizations for which there was complete information for our independent and dependent variables. These organizations belonged to 429 different four-digit Standard Industrial Classification (SIC) codes. On average, the organizations had 11,504 employees, returns on assets of 0.03, and average total assets of $2,743 million.

Dependent Variable

We created the dependent variable in three steps. First, we developed a computer program that summed the number of times each word appearing in the president's letters was used across all letters. Two coders examined the lists of words and their frequency and noted every word that might denote a negative organizational outcome and appeared at least 30 times. Following Jones and colleagues (1983), we calculated intercoder reliability using Cohen's (1960) kappa, which controls for the chance assignment of ratings to categories. Kappa equaled .77, a value within the range acceptable for this kind of analysis. The coders met to resolve disagreements and to finalize the list of negative words, which appears in Table 1.

Second, we extracted from each president's letter the paragraphs in which any of the words on the list appeared and highlighted the words. Two coders were instructed to read each of these paragraphs and to verify whether or not each word denoted a negative organizational outcome. Over 5,000 words were coded. Controlling for the number of words in a letter, we considered it more negative the more negative words it contained.

A word was coded as a negative word under two conditions: (1) The sentence in which it appeared mentioned a negative organizational outcome. The word "disappointing," for example, was coded as negative in the sentence, "Some of the disappointing operating results in 1988 flowed from internal performance shortfalls in a number of operations." (2) A sentence mentioned the environment affecting the organization negatively. The word "negative," for example, was coded as a negative word in the sentence, "A third factor, which had a negative effect on profits in the fourth quarter, was escalating prices for raw materials, namely, copper, steel and aluminum."

A word was not coded as negative under these three conditions: (1) The sentence in which it appeared mentioned neither a negative environmental effect nor a negative organizational outcome. "Failure," for example, was not coded as negative in the sentence, "The BVS (TM) is an external cardiac system that temporarily assumes the blood pumping function of the heart for

TABLE 1
Frequency of Negative Words in President's Letters

Word	Frequency	Word	Frequency
Accident	47	Inadequate	45
Adverse	147	Lack	74
Adversely	161	Lose	31
Bad	59	Losing	36
Bankruptcy	87	Loss	1,629
Concern	158	Losses	731
Concerned	80	Lost	123
Concerns	87	Missed	78
Crash	179	Negative	182
Crisis	43	Negatively	58
Deficit	57	Poor	92
Deficits	36	Problem	209
Delay	33	Problems	531
Delayed	61	Shortage	37
Delays	71	Sluggish	52
Depressed	177	Suffered	85
Deterioration	31	Tough	62
Difficult	592	Troubled	32
Difficulties	92	Unable	57
Disappointed	39	Unfavorable	53
Disappointing	188	Unfortunately	76
Disappointment	47	Unprofitable	90
Downturn	102	Unrealized	37
Downturns	34	Weak	104
Failed	32	Weakened	33
Failure	45	Weaker	54
Hazardous	79	Weakness	64
Inability	31	Worst	41

patients after open heart surgery, for patients with severe heart failure. . . ." (2) There was a mention of a negative environmental effect but no mention of the organization being negatively affected by it. The word "weakness," for example, was not coded as negative in the sentence, "In our view, the unprecedented volatility in the financial markets in the United States was unrelated to any inherent weakness in the United States economy." (3) There was a mention of a negative environmental effect but an explicit denial that it affected the organization negatively. The sentence "Since these investments were made, restaurant sales have continued to climb in a year in which other restaurant chains have had flat or negative sales gains from the previous year" illustrates this case. The intercoder reliability for this round of coding equaled .74. The coders resolved disagreements and finalized the ratings.

Coders inserted coding symbols directly into computer files containing the texts of the president's letters. A third computer program extracted the coders' judgments from the paragraphs and summed the number of negative words in each letter to form the dependent variable.

Control and Independent Variables

Control variables. Reasoning that the number of negative words in a letter might be a function of its length, we entered the total number of words in a letter as a control variable. The average industry performance and the average change in industry performance were also entered in all models as controls for industry effects (Dess, Ireland, & Hitt, 1990).

Independent variables. Table 2 lists the independent variables and their measurement. We used organizations' lists of their corporate officers in 10-K forms filed with the SEC to define who was a corporate officer.

Model 1. We used six models to test the hypotheses. Models 1a, 1b, and 1c and 2a, 2b, and 2c are similar, varying as to which variables we included in order to explore the effect of institutional shareownership on concealment. The first set of models was designed to test myopic investor theory, which suggests that institutional shareholders have a similar effect on concealment, whether or not they hold more than 5 percent of a firm's shares. In models 1a, 1b, and 1c, therefore, we examined the effect of the percentage of shares held by institutions (Hypothesis 7).

Model 2. In models 2a, 2b, and 2c we tested our modified myopic investor theory, which suggests that institutional shareholders have a different effect on concealment depending on whether or not they are dominant. Therefore, we replaced the percentage of institutional shares with two variables. To test Hypothesis 8, we added a variable for institutional control, or the presence of at least one institutional shareholder who is not an officer and holds more than 5 percent of an organization's shares. Noninstitutional investor control was defined as the presence of at least one shareholder who is neither an institution nor an officer and holds more than 5 percent. To test Hypothesis 9, we added a variable for the percentage of shares held by nondominant institutional shareholders.

To determine whether our modified myopic theory accounted for more variance than the unmodified theory, we used an *F*-test to explore if models 2a, 2b, and 2c accounted for more variance than models 1a, 1b, and 1c.

Model 3. We used model 3 to test for intentionality (Hypothesis 11). Staw and colleagues (1983) hypothesized that corporate officers use self-serving attributions intentionally in president's letters to prop up the value of their shares long enough to sell them and avoid a loss. They tested this hypothesis using a zero-order correlation between the number of self-serving attributions in president's letters and the sale of stock by corporate officers in the quarter subsequent to the disclosure of the letters. They concluded from their study that "self-serving attributions were a form of impression management, rather than a genuine expression of optimism, since enhancement [in the President's letter] was associated with subsequent selling of stock by corporate officers" (Staw et al., 1983: 582). In direct parallel to Staw and colleagues, we hypothesized that corporate officers conceal negative outcomes intentionally to prop up the value of their shares. We used the percentage of negative words as an independent variable in model 3 and

TABLE 2
Definition of Variables

Variable	Description
Return on assets	Net income divided by total assets
Change in return on assets	Return on assets in year $t - 1$ subtracted from returns on assets in year t
Percentage of outsiders	Number of directors who are not corporate officers divided by total number of directors
Percentage of shares held by outsiders	Number of shares held by directors who are not corporate officers divided by total number of shares
Percentage of shares held by officers	Number of shares held by corporate officers as listed in 10-K divided by total number of shares
Percentage of shares held by institutional shareholders	Number of shares held by institutional shareholders divided by total number of shares
Owner control	Dummy variable coded 1 for organizations in which at least one shareholder, neither an institution nor an officer, owns 5 percent or more of shares and 0 for other organizations
Noninstitutional investor control	Dummy variable coded 1 for organizations in which at least one shareholder, who is neither an institutional shareholder nor an officer in the organization, owns 5 percent or more of this organization's shares and 0 for other organizations
Institutional investor control	Dummy variable coded 1 for organizations in which at least one institutional shareholder, not an officer, owns 5 percent or more of shares and 0 for other organizations
Percentage of shares held by nondominant institutional shareholders	Number of shares held by institutional investors, each of which holds less than 5 percent of shares, divided by the total number of shares
Auditor's report	Dummy variable coded 1 for qualified and 0 for unqualified auditor's report
Number of officers selling shares	Number of officers who sold shares of the organization they manage in the quarter after its president's letter was disclosed
Value of shares sold by officers	Value of shares sold by officers in the quarter after letter disclosure
Number of outside directors selling shares	Number of outside directors who sold shares in the organization in which they are board members in the quarter after letter disclosure
Value of shares sold by outside directors	Value of shares sold in the quarter after letter disclosure by outside directors

used the sale of shares by corporate officers as the dependent variable. Unlike Staw and colleagues, however, we added control variables.

RESULTS

Table 3 reports the correlation matrix for the independent and dependent variables as well as means and standard deviations.

TABLE 3
Means, Standard Deviations, and Correlations[a]

Variables	Means	s.d.	1	2	3	4	5	6	7	8	9	10
1. Number of negative words	3.05	3.96										
2. Total number of words	1,125	748	.30									
3. Change in average industry performance	−0.04	1.23	−.02	.02								
4. Average industry performance	−0.17	13.01	−.01	−.06	.82							
5. Change in performance	0.01	0.09	−.05	.05	−.03	.02						
6. Performance	0.03	0.13	−.35	−.05	−.03	.01	.49					
7. Percentage of outsiders	0.70	0.17	.06	.07	.06	.02	.04	−.01				
8. Percentage of shares held by outsiders	1.36	4.12	−.04	−.05	−.02	.15	−.02	.00	.05			
9. Percentage of shares held by officers	6.39	12.30	−.05	−.11	.02	.01	−.04	−.03	−.34	.05		
10. Owner control	0.60	0.49	.05	−.05	.03	.00	−.04	−.09	.03	.07	−.04	
11. Percentage of shares held by institutions	33.75	20.79	−.11	.15	−.01	−.03	.06	.16	.24	−.12	−.26	.05
12. Noninstitutional investor control	0.48	0.50	.05	−.01	.01	.01	−.01	−.08	.03	.07	−.05	.78
13. Institutional investor control	0.40	0.49	.04	.01	−.02	−.03	−.02	−.04	.05	.00	−.04	.60
14. Percentage of shares held by nondominant institutional investors	25.91	18.30	−.15	.15	−.00	−.02	.07	.18	.24	−.14	−.26	−.06
15. Auditor's opinion	0.05	0.22	.24	.04	.05	.00	.03	−.23	.05	.02	−.04	.02
16. Percentage of negative words	0.00	0.00	.74	−.07	−.02	.00	−.14	−.30	−.00	−.03	.05	.06
17. Number of officers selling shares	0.40	1.06	−.08	.10	.06	−.01	.02	.09	−.00	−.03	−.07	−.07
18. Number of officers with shares	5.14	4.35	−.06	.15	.01	.00	−.01	.08	−.03	.06	−.04	−.08
19. Value of shares sold by officers[b]	141	635	−.08	.04	.07	−.00	.01	.09	−.05	−.04	−.02	−.03
20. Value of shares held by officers[b]	17,686	77,854	−.06	.04	−.01	−.00	−.00	.10	−.13	−.04	.33	−.12
21. Number of outside directors selling shares	0.06	0.28	−.07	.05	.00	−.00	.01	.04	.02	.01	−.03	−.05
22. Number of outside directors with shares	2.28	2.04	.00	.11	.01	.02	.03	.06	.29	.16	−.16	−.01
23. Value of shares sold by outside directors[b]	49	662	−.04	.00	−.01	−.00	.05	.10	−.03	−.01	.03	−.01
24. Value of shares held by outside directors[b]	3,789	18,300	−.01	.02	.01	.03	.04	.10	.06	.21	−.04	−.00

[a] N ranges from 991 to 1,331. Correlations with absolute values greater than .05 are significant at .05; those greater than .07, at .01; and those greater than .08, at .001.

[b] Expressed in thousands of dollars.

TABLE 3 (continued)

Variables	11	12	13	14	15	16	17	18	19	20	21	22	23
1. Number of negative words													
2. Total number of words													
3. Change in average industry performance													
4. Average industry performance													
5. Change in performance													
6. Performance													
7. Percentage of outsiders													
8. Percentage of shares held by outsiders													
9. Percentage of shares held by officers													
10. Owner control													
11. Percentage of shares held by institutions													
12. Noninstitutional investor control	−.10												
13. Institutional investor control	.39	.29											
14. Percentage of shares held by nondominant institutional investors	.87	−.08	.08										
15. Auditor's opinion	−.12	.02	−.06	−.11									
16. Percentage of negative words	−.21	.05	.02	−.23	.21								
17. Number of officers selling shares	.23	−.05	−.04	.29	−.07	−.13							
18. Number of officers with shares	.38	−.12	.04	.45	−.07	−.13	.50						
19. Value of shares sold by officers[b]	.17	−.03	.04	.21	−.05	−.09	.60	.31					
20. Value of shares held by officers[b]	.05	−.05	−.11	.10	−.05	−.06	.14	.15	.25				
21. Number of outside directors selling shares	.10	−.01	−.04	.13	−.02	−.08	.16	.09	.19	.04			
22. Number of outside directors with shares	.25	−.01	.03	.29	−.02	−.06	.18	.27	.08	.03	.15		
23. Value of shares sold by outside directors[b]	.04	.02	−.03	.06	−.02	−.05	.10	.02	.05	.04	.34	.03	
24. Value of shares held by outside directors[b]	.09	−.01	−.03	.12	−.03	−.03	.10	.10	.07	.03	.08	.25	.12

Multicollinearity. Table 3 reveals a high correlation between financial performance and change in financial performance at both an organizational and industry level. This multicollinearity probably occurs because high performers in a given year tend to have experienced sharp performance increases in the previous year, low performers, sharp decreases, and average performers, minor changes.

Table 3 also reveals that strong performance and a qualified auditor's opinion are negatively correlated. This link may occur because firms performing poorly come under greater scrutiny by accountants and consequently tend to receive qualified opinions (Schick & Ponemon, 1993).

Multicollinearity is not a problem for absolute industry-level performance and change in industry-level performance because these are only control variables. It is a problem, however, for absolute organizational performance, change in organizational performance, and auditor's opinion because these variables were used to test hypotheses. We dealt with these problems in three stages. We first ran ordinary-least-squares regression models without absolute organizational performance, excluding this variable from the first stage because we assumed that it was caused by change in organizational performance. In the second stage, we added absolute organizational performance, and in the third, auditor's opinion. We used an F-test to evaluate the significance of resulting increases in R^2. Table 4 reports the results.[1]

Hypotheses. The results of models 1a and 2a indicate, in support of Hypothesis 1, that the greater the decline in an organization's financial performance, the greater the negativity of its president's letters. These results also support Hypothesis 2. When the absolute organizational performance measure was added to the model, the increase in R^2 was significant. Comparing model 1a to 1b and models 2a to 2b reveals, however, that the sign of the performance change coefficient changes with the addition of the absolute performance variable. Multicollinearity renders sample estimates of coefficients unstable. Therefore, we attribute the instability of the performance-change coefficient in models 1b and 2b to the high correlation between performance and change in performance, and we take the results of models 1a and 2a as support for Hypothesis 1.

Results also support Hypothesis 3. The greater the proportion of outside directors on the board of an organization, the greater the negativity of its president's letter. However, the greater the proportional share ownership by outside directors, the smaller the negativity of the president's letter, contrary to what Hypothesis 4 predicted.

Hypothesis 5 received no support. The relation between the proportion of shares held by corporate officers and the negativity of the president's letters was not significant. The results of our test of the relation between the

[1] We calculated two other models with return on equity and returns on invested capital rather than return on assets. The results were not substantially different.

proportion of shares held by a firm's chief executive and negativity (not reported) were also insignificant. Hypothesis 6 received weak support. The president's letters of owner-controlled organizations were only marginally more negative than those of other organizations in the full model.

All hypotheses bearing on institutional investors were supported. Models 1a, 1b, and 1c were consistent with the claim, made in Hypothesis 7, that the greater the proportion of stock owned by institutions, the lower the negativity in president's letters. Models 2a, 2b, and 2c indicate, as Hypothesis 8 predicts, that the letters of institutional investor–controlled organizations are more negative than those of other organizations. Moreover, noninstitutional control had no significant effect. In accordance with Hypothesis 9, however, the greater the proportional share ownership by nondominant institutional investors, the less negative the president's letters. We also found, in support of our modified myopic investor theory, that models 2a, 2b, and 2c explained a significantly greater proportion of the variance than did models 1a, 1b, and 1c.

Hypothesis 10 was also supported. The increments in R^2 that occurred when we added auditor's opinion to models 1c and 2c were significant.

We tested two variants of model 3. In model 3a, we regressed the number of officers who sold shares in their company in the quarter after the president's letter was disclosed on two control variables: (1) the number of officers holding such shares and (2) change in return on assets (ROA). We controlled for the first because it might influence the number of officers selling shares and for the second because it might cause changes in stock price and stock selling. We did not add the negative words variable in the first stage because of its correlation with change in ROA but added it in the second stage and used an F-test to examine the R^2s. We followed a similar procedure for model 3b, using the value of shares officers sold as a dependent variable and the value of shares officers held as a control.

As Table 5 indicates, Hypothesis 11 was supported by both models 3a and 3b. We found that, with change in financial performance controlled, the smaller the percentage of negative words in a president's letters, the greatest the number of top officers selling shares in the next quarter and the higher the value of the shares they sold.

DISCUSSION

Financial Performance

We found that both financial performance and changes in financial performance were correlated with negativity in president's letters. This finding suggests that when financial performance is low, officers have more negative organizational outcomes to disclose and, consequently, account for them in president's letters. The Securities and Exchange Commission and accountants may reinforce this tendency by forcing officers to disclose poor financial results.

TABLE 4
Results of Regression Analyses for the Number of Negative Words in President's Letters[a]

	Myopic Investor Models			Modified Myopic Investor Models		
Variables	**1a**	**1b**	**1c**	**2a**	**2b**	**2c**
Intercept	0.15	0.58	0.45	0.43	0.75	0.62
	(0.64)	(0.61)	(0.61)	(0.60)	(0.57)	(0.57)
Total number of words	0.0021***	0.0020***	0.0020***	0.0021***	0.0020***	0.0020***
	(0.0002)	(0.0002)	(0.0002)	(0.0002)	(0.0002)	(0.0002)
Change in industry average performance	−0.22	−0.19	−0.21	−0.18	−0.17	−0.19
	(0.16)	(0.15)	(0.15)	(0.16)	(0.15)	(0.15)
Industry average performance	0.11	0.05	0.05	0.07	0.03	0.03
	(0.18)	(0.17)	(0.17)	(0.17)	(0.17)	(0.16)
Change in performance	−2.58*	5.05***	4.11**	−2.39*	4.89***	3.95**
	(1.17)	(1.29)	(1.31)	(1.16)	(1.28)	(1.30)
Performance		−16.36***	−14.68***		−15.71***	−14.00***
		(1.42)	(1.46)		(1.41)	(1.45)
Percentage of outsiders	1.87**	1.63*	1.47*	2.14**	1.87**	1.71**
	(0.73)	(0.69)	(0.69)	(0.72)	(0.68)	(0.68)
Percentage of shares held by outsiders	−0.06*	−0.05†	−0.05*	−0.07**	−0.05*	−0.06*
	(0.03)	(0.03)	(0.02)	(0.03)	(0.02)	(0.02)
Percentage of shares held by officers	−0.014	0.002	0.004	−0.015	−0.0004	−0.0008
	(0.010)	(0.009)	(0.009)	(0.010)	(0.0092)	(0.0092)

TABLE 4 (continued)

Variables	Myopic Investor Models			Modified Myopic Investor Models		
	1a	1b	1c	2a	2b	2c
Owner control	0.97**	0.51	0.55†			
	(0.34)	(0.32)	(0.33)			
Percentage of shares held by institutions	−0.0383***	−0.0189***	−0.0170**			
	(0.0058)	(0.0057)	(0.0057)			
Noninstitutional investor control				0.33	0.11	0.13
				(0.24)	(0.23)	(0.23)
Institutional investor control				0.50*	0.39†	0.45*
				(0.23)	(0.21)	(0.22)
Percentage of shares held by nondominant institutional investors				−0.05***	−0.03***	−0.03***
				(0.01)	(0.01)	(0.01)
Auditor's opinion			2.13***			2.14***
			(0.48)			(0.48)
R^2	15.62	24.62	25.95	17.37	25.67	27.00
Adjusted R^2	(14.94)	(23.94)	(25.20)	(16.62)	(24.93)	(26.20)
F for increment in R^2 over the previous column		132.17***	19.86***		123.50***	19.93***
F for increment in R^2 over models 1a, 1b, and 1c				23.44***	15.62***	15.74***

[a] Standard errors appear in parentheses under coefficients. $N = 1{,}118$ except, for models 1c and 2c, where $N = 1{,}107$.

†$p < .10$
* $p < .05$
** $p < .01$
*** $p < .001$

TABLE 5
Results of Regression Analyses for Officers' Sales of Shares[a]

	Model 3a: Officers Selling Shares				Model 3b: Value of Shares Sold			
	Step 1		Step 2		Step 1		Step 2	
Variables	*b*	s.e.	*b*	s.e.	*b*	s.e.	*b*	s.e.
Intercept	−0.30***	0.04	−0.24***	0.05	105,897***	19,209	147,280***	24,472
Number of officers with shares	0.13***	0.01	0.12***	0.01				
Value of shares held by officers					0.0020***	0.0002	0.0019***	0.0002
Change in performance	0.18	0.17	0.13	0.17	25,904	130,050	−22,776	130,911
Percentage of negative words			−18.58**	7.37			−13,887,931**	5,111,912
R^2	25.47	25.34	25.88	25.68	6.15	5.98	6.77	6.52
Adjusted R^2								
F for increment in R^2			6.38*				7.38**	

[a] N = 1,157 for model 3a and 1,114 for model 3b.
* $p < .05$
** $p < .01$
*** $p < .001$

Boards of Directors

We made and supported the claim that boards with proportionally more outside directors are more motivated to limit concealment of negative outcomes. Contrary to what was hypothesized, however, greater proportional share ownership by outside directors correlated negatively with disclosure. This result is important because shareholding by outside directors is usually assumed to make board monitoring more effective by aligning directors' and shareholders' long-term interests (Johnson et al., 1993; Kosnik, 1990; Miller & Komorita, 1987).

One possible explanation for our finding is that high share ownership by board outsiders may bias them toward tolerating the release of fewer negative organizational outcomes. They may be so biased because the disclosure of negative outcomes would reduce the value of their equity.

We carried out additional analyses to explore this hypothesis of self-interested behavior by outside director–shareholders, reasoning that if they intentionally tolerated concealment, they should tend to sell at least some shares quickly, before concealed negative organizational outcomes surface.

We tested this hypothesis using the same approach we used for exploring the intentionality of concealment by corporate officers. In model 4a, we regressed the number of outsider shareholders who sold shares in their companies in the quarter after the president's letters were disclosed on two control variables: the number of outsider shareholders holding such shares and change in ROA. We then added the percentage-of-negative-words variable to the model and used an F-test to examine the resultant R^2s. In model 4b, the value of shares outsider shareholders sold was the dependent variable, and the value of shares they held was a control. We expected a significant, negative coefficient for the percentage of negative words. As Table 6 indicates, results are weak yet consistent with the claim that at least some board outsiders who are shareholders intentionally tolerate concealment by corporate officers in order to prop up the value of their equity.

Shareholding by Corporate Officers

The results provided no support for the hypothesis that officers holding a high proportion of their organization's equity conceal negative organizational outcomes less extensively in president's letters. Share ownership by corporate officers and negativity were not significantly correlated.

These results need to be discussed because our two hypotheses based on agency theory and supporting research suggest that managerial ownership should limit concealment: (1) the convergence-of-interest hypothesis, according to which managerial shareholding aligns managers' and shareholders' interests, and (2) the management entrenchment hypothesis: managerial shareholding empowers managers (Morck et al., 1988).

One possible explanation for this divergence from expectation is that share ownership by corporate officers creates countervailing pressures on them. On the one hand, in their role as stockholders, they may be inclined

TABLE 6
Results of Regression Analyses for Outside Directors' Sales of Shares[a]

	Model 4a: Outsiders Selling Shares				Model 4b: Value of Shares Sold			
	Step 1		Step 2		Step 1		Step 2	
Variables	***b***	**s.e.**	***b***	**s.e.**	***b***	**s.e.**	***b***	**s.e.**
Intercept	−0.0041	0.0155	0.0125	0.0173	17,495**	5,587	26,650***	7,115
Number of outsiders with shares	0.0225***	0.0045	0.0219***	0.0045				
Value of shares held by outsiders					0.0006*	0.0003	0.0005*	0.0003
Change in performance	−0.02	0.05	−0.03	0.05	15,360	36,727	−24,238	36,916
Percentage of negative words			−5.05*	2.36			−3,081,668*	1,486,918
R^2	2.36	2.17	2.80	2.52	0.45	0.25	0.89	0.58
Adjusted R^2								
F for increment in R^2			4.58*				4.36*	

[a] N = 1,016 for model 4a and 988 for model 4b.

* $p < .05$

** $p < .01$

*** $p < .001$

to reveal negative outcomes. On the other hand, in their role as insiders, they may be inclined to conceal negative outcomes because disclosing them could reduce the value of their equity holdings. If these countervailing pressures tend to cancel each other out, shareholding by corporate officers may have little effect on concealment.

Institutional Investors

The results of the tests of models 1a, 1b, and 1c support myopic investor theory, that according to which institutional investors have a short-term orientation toward their investments that discourage officers from disclosing negative organizational outcomes to jittery institutional investors. The negative correlation between the negativity of president's letters and the percentage of shares held by institutional investors bears out the theory.

We also explored the idea that myopic investor theory pertains only to institutional investors that hold small and easily salable blocks of stock. The results did indicate that the negativity of an organization's president's letters is negatively correlated with the percentage of the organization's shares held by nondominant institutional investors. Our modification of myopic investor theory suggests that institutional investors holding large blocks of stock cannot dispose of these blocks quickly for short-term gains. They would more likely act in their long-term interest and pressure officers to provide clear and accurate disclosures of their organization's financial health. We found support for this argument with results indicating that the negativity of president's letters is greater for organizations controlled by institutions than for other organizations. Moreover, the models for our modified myopic investor theory accounted for more variance than those for the unmodified theory.

Interestingly, the results did not support the claim that dominant noninstitutional shareholders force greater disclosure of negative organizational outcomes by corporate officers. These results may have occurred because managers may perceive these shareholders as less active in monitoring managerial communications than dominant institutional shareholders. Or perhaps dominant noninstitutional shareholders communicate directly with management and do not have to depend on president's letters to find out about negative organizational outcomes. Whatever the reason, these results highlight the need for more research that distinguishes the effects of dominant institutional and noninstitutional shareholders on organizations.

Accountants

As we noted above, agency theorists recognize the possibility that accountants, by virtue of their expert knowledge, can reduce information asymmetries between shareholders and managers, thereby forcing managers to disclose more negative organizational outcomes (Baiman, 1990). Certain agency theorists, however, have raised the possibility that information asymmetries and conflicts of interests between accountants and shareholders generate agency problems between not only managers and shareholders, but

also between the accountants and shareholders (Antle, 1982; Baiman, Evans, & Noel, 1987). Information asymmetries come into play when an organization's shareholders do not have the information necessary to verify whether accountants are auditing the organization carefully. Conflicts of interests occur because, whereas shareholders' interests dictate that accountants audit their organization carefully, work-averse accountants' interests dictate that they not expend the effort necessary for such a careful audit. As a result of this agency problem, accountants may overlook officers' concealment strategies.

Our results do not support this claim but rather, are consistent with the claim that accountants play an important role in forestalling concealment strategies by corporate officers. Accountants may play this role because careless audits expose them to the risk of liability suits and loss of reputation, if concealment strategies that they should have detected do come to light.

Intentionality

If corporate officers conceal negative organizational outcomes, do they do so intentionally, in the course of a conscious communication strategy, or unintentionally, as a result of concealing negative organizational outcomes that threaten their self-esteem not only from shareholders, but from themselves as well? Concealment by certain corporate officers appears to be an intentional attempt to avoid losses on the value of their shares, rather than a genuine expression of optimism. Although the results are weak, they indicate that the disclosure of fewer negative organizational outcomes in president's letters is associated with greater subsequent selling of stock by corporate officers. These results are consistent with Staw and colleagues' (1983) findings, which were derived from a method similar to the one used here.

Results of the post hoc analyses (Table 6) also support the claim that the outside directors of certain organizations intentionally tolerate concealment strategies in order to use their inside information to sell their shares while they are still overvalued. These results, though weak, are important because shareholding by outside directors is usually assumed to make board monitoring more effective (Johnson et al., 1993; Kosnik, 1990; Miller & Komorita, 1987). More generally, this study suggests the occurrence of what might be called "directorialism"—outside directors acting in their own rather than shareholders' interests.

CONCLUSIONS

This study set out, using a large number of letters from firms' presidents contained in the firms' annual reports, to test if and when officers use concealment strategies in their communications with shareholders. Our central thesis was that by studying the effects of shareholders, directors, and accountants on corporate officers' communications to shareholders through these letters, we could establish if and when concealment occurred. We argued that if we found that certain directors, shareholders, or accountants

affected the disclosure of negative organizational outcomes, we would have evidence consistent with the claim that officers tend to conceal such outcomes unless they are forced to disclose them. We also argued that if we found that concealment was associated with subsequent short-term stock-selling by officers, we would have evidence that (1) certain managers engage in concealment strategies in order to exploit inside information and sell their overvalued shares and (2) some managerial concealment is intentional.

Results were consistent with the claim that accountants and certain types of shareholders and directors prompt officers to reveal negative outcomes, whereas others promote concealment. We also found evidence for the claim that some concealment and its toleration by outside directors may be intentional. Clearly, more research is necessary on this sensitive issue. This study suggests a number of other directions for future research on concealment by corporate officers.

First, we have highlighted the role of boards in limiting concealment by corporate officers. We focused primarily on factors affecting board motivation to pressure organizations to reveal negative organizational outcomes. Future research could examine how board members' ability to obtain rich information allows them to detect the use of concealment strategies. Eisenhardt argued that "operationally, the richness of board information can be measured in terms of characteristics such as frequency of board meetings, number of board members with long tenure, number of board members with managerial and industry experience, and number of board members representing specific ownership groups" (1989: 65).

Second, the study highlighted the effect institutional investors have on concealment by corporate officers. Research replicating our findings is needed. Such research is necessary because, between 1977 and 1986, the percentage of company stock held by institutional investors increased steadily from 17 to 39 percent (Hansen & Hill, 1991), and it reached 50.3 percent by 1993 (*Fortune*, 1993). If this trend persists, institutional investors can be expected to have an even greater influence on corporate disclosures in years to come.

Third, we examined concealment in one communication context: officer-shareholder communication. Many other contexts could be investigated, including superior-subordinate, management-labor, and management-regulator communications. We examined the roles of shareholders, directors, and accountants in limiting concealment by corporate officers. The roles of other individuals and institutions could be investigated: financial analysts, worker unions, the Securities and Exchange Commission, and journalists.

Such research is important for scholars and practitioners alike as it advances scholarship from two perspectives based on the assumption that when shareholders, or those acting on their behalf, cannot verify whose interests corporate officers are serving, those officers tend to pursue their own interests: symbolic management theory (Pfeffer, 1981) and agency theory (Eisenhardt, 1989).

The symbolic management literature has described various strategies that officers use to further their interests over those of uninformed shareholders (Ashforth & Gibbs, 1990; Pfeffer, 1981). There has been little previous research, however, on when and how extensively individuals or institutions limit corporate officers' use of these strategies (Abrahamson, 1988).

Eisenhardt argued that the statements of Perrow (1986) and others that agency theory is excessively narrow and has few testable implications suggest the need to expand agency theory to a "richer and more complex range of contexts" (1989: 71). Agency theorists have said little about how agents use language and other symbols to further their own interests. In agency theory, information is treated as a commodity that can be bought and sold directly rather than as something that must be transmitted using information-conveying symbols. Consequently, agency theory can be greatly enriched by studies, like this one, that consider how agents use information-conveying symbols to pursue self-interested behaviors (Eisenhardt, 1989; Walsh & Seward, 1990). By the same token, this study indicates that agency theory can serve as a powerful guide for this type of research.

From a practitioner point of view, research on officers' communication strategies toward shareholders helps individuals and institutions who invest in corporations and depend on accurate communication about their well-being to guide investment decisions. Such research also helps those who manage such investments. Finally, such research might help individuals and institutions, such as the Securities and Exchange Commission, boards of directors, and accountants, that are entrusted with the task of regulating officers' communications to shareholders to ensure the integrity of the corporate form of organization.

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