# Ferri, Zheng & Zou (2018)

**Uncertainty about managers' reporting objectives and investors' response to earnings reports: Evidence from the 2006 executive compensation disclosures**

Gabriel Voelcker and Thobias Zani

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# Presentation

1. The Model

2. The Shock

3. Research Design

4. Results

5. Additional Analyses

6. Conclusion and Future Research

# The Model

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- How do the investors interpret the bias?

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- $\sigma_v^2$ = prior uncertainty about firm value.
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- $c$ = marginal cost of adding bias in the report.
- Ferri et al. (2018) focuses on the **investors' uncertainty regarding manager's compensation**($\sigma_x^2$).

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  - Performance metrics (weight, multiple metrics, exact definition).
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- Strong assumption: uncertainty regarding the manager's objectives was the **only** parameter from the ERC equation (2) affected by the CD&A shock.

# Research Design

- Identification strategy: December FY-end firms as *treatment* (first subject to the new rules - 88% of the sample); Sep/Oct/Nov FY-end as *control* (last to comply with the rules - 12%).
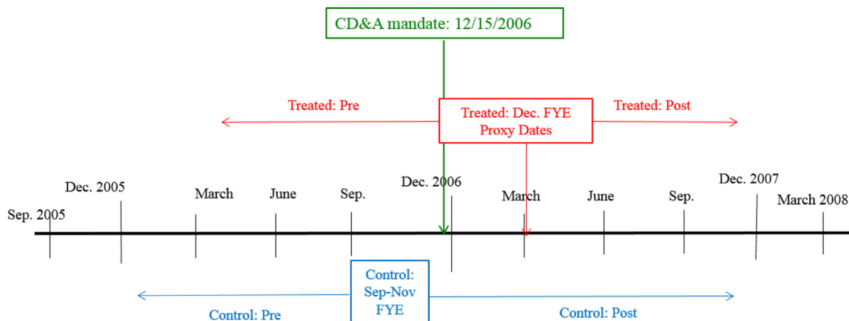
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**Fig. 3.** Timeline

- Source: Ferri et al(2018), Figure 3.

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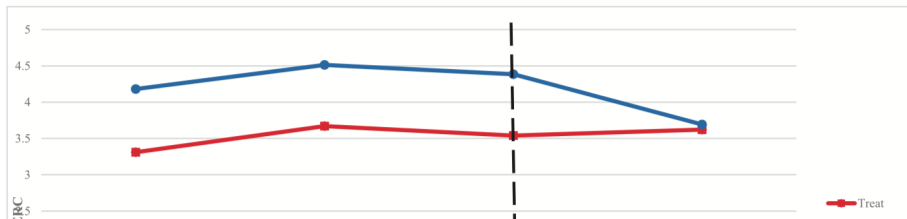
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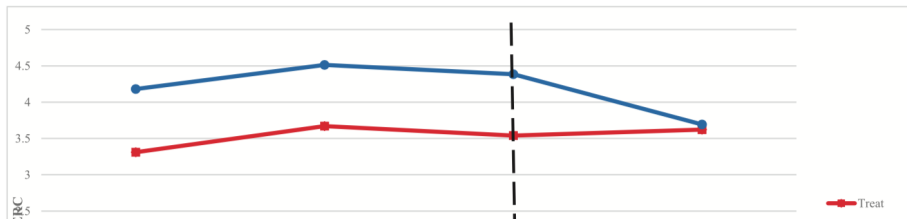- $CAR_{i,t}$ is the 3-day market adjusted stock return around the date of quarterly earnings announcements.
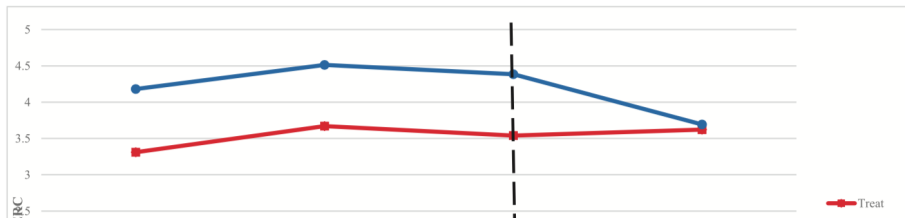
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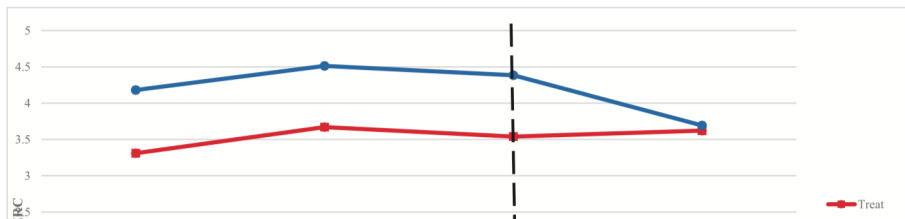
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- No indication of a different trend in ERCs prior to the CD&A rules:
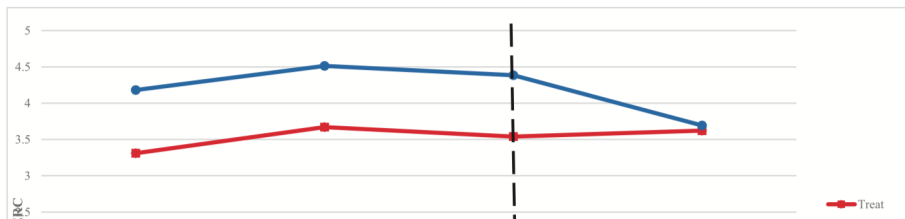
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Panel B Entropy balancing results

| VARIABLES | (1) OLS | (2) Robust | (3) Robust | (4) Robust | (5) Robust | (6) Robust |
|---|---|---|---|---|---|---|
| UE*POST*TREAT | | | 1.356*** | 0.925** | 3.472*** | 1.969** |
| | | | (3.25) | (2.52) | (4.35) | (2.13) |
| UE | 1.324*** | 1.394*** | 2.541*** | 4.808*** | 7.197*** | 8.233*** |
| | (15.32) | (24.61) | (7.05) | (9.49) | (9.65) | (9.96) |
| UE*POST | | | −1.546*** | −0.213 | −2.525*** | −1.843** |
| | | | (−3.92) | (−0.45) | (−3.44) | (−2.09) |
| UE*TREAT | | | −1.071*** | −1.168*** | −3.607*** | −3.152*** |
| | | | (−2.89) | (−3.63) | (−5.18) | (−3.96) |
| UE*Log(Size) | | | | −0.162** | −0.140** | −0.189*** |
| | | | | (−2.53) | (−2.32) | (−3.24) |
| UE*Market-to-Book | | | | 0.082*** | 0.088*** | 0.054*** |
| | | | | (4.77) | (5.05) | (2.70) |
| UE*Beta | | | | 0.346*** | 0.370*** | 0.310*** |
| | | | | (2.68) | (3.05) | (2.77) |
| UE*Leverage | | | | −0.101*** | −0.116*** | −0.070* |
| | | | | (−2.93) | (−3.39) | (−1.95) |
| UE*Persistence | | | | 0.086 | −0.159 | 0.470* |
| | | | | (0.33) | (−0.63) | (1.74) |
| UE*Loss | | | | −3.414*** | −6.242*** | −5.966*** |
| | | | | (−16.47) | (−8.23) | (−7.25) |
| UE*Dispersion | | | | −1.888*** | −2.804*** | −0.693** |
| | | | | (−3.62) | (−5.05) | (−2.11) |
| UE*Loss*POST*TREAT | | | | | −3.051*** | −4.364*** |
| | | | | | (−3.45) | (−4.60) |
| Nonlinear | | | | | | −29.263 |
| | | | | | | (−1.51) |
| Nonlinear*TREAT | | | | | | −35.741* |
| | | | | | | (−1.70) |

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- Robustness tests.

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  - Ex ante expected improvements: firms with higher excess CEO pay are subject to greater pressure to improve their disclosures(a). Distinguishes firms that received SEC comment letters(b). Results presented in **Table 5**: both positive and significant coefficients $1.486^{***}$(a) and $3.595^{***}$(b).

## Additional Analyses

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- Increase(decrease) in marginal cost of adding bias to the earnings report: $c$.
- **Table 6**: tests diff-in-diff changes for executives compensation(Panel A) and firm characteristics (Panel B). Evidence does not suggest differential changes when CD&A was introduced.

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- However, the change in ERC doesn't differ among loss firms, suggesting enhanced compensation disclosures have limited usefulness in reducing investors' uncertainty about the manager's reporting objectives.

- Suggestion of future research: re-examine F&V(2000) predictions using new regulatory changes or changes in other jurisdictions (should improve).

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- Methodology similar to Gipper, Leuz and Maffett(2019): lack of a benchmark of what the the change in ERC should be. Alternatives to converting the ERC measure to cost of capital terms. Volatility?

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- From section 5: how do we measure the informativeness and also informativeness change of disclosure? Textual analysis? Market reaction? Other proxies?

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