Peer effects may influence early disclosures for businesses

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A study conducted by Phong Truong, assistant professor of accounting in the Penn State Smeal College of Business, found that peer effects—the influence that behaviors of a single individual or entity have on others in a group or community—are a significant reason companies decide to file early earnings reports. Credit: Oren Elbaz/Unsplash

Edging a competitor out of the spotlight is one reason why companies tend to make announcements, such as earnings reports, earlier than they are legally required, according to a Penn State researcher. The push to report information early may also increase the accounting costs on smaller publicly traded corporations, which are supposed to be protected by rules on when firms must issue disclosure, according to a Penn State researcher.

In the study, Phong Truong, assistant professor of accounting in the Smeal College of Business, found that peer effects—the influence that behaviors of a single individual or entity have on others in a group or community—are a significant reason companies decide to file early earnings reports. The findings suggest that policymakers should take peer effects into account when crafting disclosure regulations to better protect smaller firms. The study, which is published online in *The Accounting Review*, will appear in print in May.

"What this means is that, all else equal, if my peers announce earnings early, I will feel pressure to also announce my earnings early," said Truong. "If a company announces early, it can attract more attention from the market, resulting in heightened media coverage and greater public interest. Consequently, other late announcers might experience a loss of market attention, which could be detrimental to them. To avoid this negative impact on their visibility in the capital markets, other companies find themselves in a position where they have to take action to regain that attention."

Real costs with early disclosures

The Securities and Exchange Commission—SEC—establishes rules on when public companies must disclose information; however, companies can choose to release information early. The SEC also allows smaller companies more time to make public disclosures. The commission

defines company size based on the market value of its public float. Public float is the number of a company's outstanding shares that are available for trading and that are not held by insiders. For example, a company that issued a total of 1 million shares of stock, but 100,000 shares are held by insiders or otherwise restricted from public trading, would have a public float of 900,000 shares.

Under SEC rules, companies with a market value of public float worth less than $75 million have 45 days to file their quarterly reports, whereas firms with floats above this threshold have just 40 days. For annual reports, the deadline for firms in the former group is 90 days. Firms in the latter group, however, have either 60 days or 75 days to file their reports.

Truong said there are real costs and additional burdens associated with the phenomenon, especially for smaller firms. For example, companies may need to rush to complete financial reports, audits, and other preparations before they can announce earnings early. In fact, these costs were taken into consideration when the SEC created the two-tier system based on public float values. However, while the disclosure rules are established to help smaller companies, the presence of peer effects may end up undermining this goal.

"This is not just about taking a day or two to announce earnings earlier or later; it does have a material impact," said Truong. "Pushing the announcement date early is not as easy as it may seem for a company to do. In addition to the accounting costs to ensure the accuracy and availability of necessary information for an early disclosure, companies typically face increases in audit fees to have the information audited and reviewed before release. In addition, changing the announcement date could create logistical issues and disrupt previously scheduled activities with other parties such as equity analysts and lawyers. Thus, when firms are pressured to announce early because of peer effects, they are likely

to incur various additional costs. So, in a sense, while the regulation was trying to protect smaller firms, the peer effects [in earnings announcement timing] sort of defeat that purpose, resulting in unintended costs for these firms."

To study peer effects on early disclosure, Truong relied on data for all publicly traded U.S. firms from 2007 to 2016. Competing firms are grouped together and identified through a three-digit Standard Industrial Classification (SIC) code.

He identified the earnings announcement date for each firm in each quarter during the sample period and used information about when the competitor companies were required by law to announce their earnings. This allowed Truong to measure how much influence the competitors had on a company's decision to disclose early, while accounting for other factors that might also affect that decision.

Future work

Recognizing that peer effects represent a large part of the motivation for the timing of disclosures, Truong said that future research could investigate developing regulations concerning the timing of information releases that are fairer and less of a financial burden on smaller firms.

"What this study says is that policymakers and regulators need to take these peer effects—not just direct effects—into account," said Truong. "For example, the intensity of a regulation need not be so strong at the outset to achieve the intended outcomes. In addition, future research could explore optimal regulations to guide early disclosures, including determining the optimal public float thresholds and regulatory reporting deadlines for different groups of companies. These are questions that are outside the scope of my paper."

More information: Phong Truong, Peer Effects and Disclosure Timing: Evidence from Earnings Announcements, *The Accounting Review* (2022). DOI: 10.2308/TAR-2020-0311

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