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Politically conservative CEOs found to think differently about transparency

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As a purely voluntary form of disclosure, management earnings forecasts may tell us as much about the managers themselves as about their company's financial future. All sorts of personality traits may influence the content and cadence of forecasts, but you would expect core attributes—such as political ideology, which has been likened to an "official religion" in the United States—to be the most salient.

Indeed, Lei Gao, associate professor of finance at the Donald G. Costello College of Business at George Mason University, recently published a paper in the *Journal of Financial and Quantitative Analysis* finding that politically conservative CEOs handle forecasts very differently from their moderate or liberal peers.

Gao's co-authors were Ahmed Elnahas of the University of Texas, Md Nomad Hossain of Central Washington University, and Jeong-Bon Kim of Simon Fraser University.

The researchers analyzed forecasts for a wide range of companies over the period 1993-2016, comparing those issued by conservative CEOs to the rest of the sample. They used financial contributions to Republican Party candidates as an index of conservatism. They also gathered data on actual financial performance to measure forecast accuracy.

They found that conservative CEOs were 13-16.5 percent more likely to issue forecasts in a given year. Conservative-CEO forecasts were 12.7 percent more likely to offer range predictions instead of a precise figure.

Republican-supporting CEOs also tended to allow more time between the forecast and the next earnings announcement, with an average horizon of about 11 percent, or around seven or eight days, longer than their non-conservative counterparts. And these forecasts were, on average, 8.7 percent more accurate—perhaps not surprisingly, given their more measured claims.

Putting their findings through the statistical wringer, the researchers explored the possibility that the difference might lie with entrenched firm behavior rather than the CEO's political ideology. However, they could spot no shared characteristics of firms led by conservatives outside of the aforementioned forecasting patterns.

Plus, firms that replaced Republican with non-Republican CEOs promptly exhibited decreased forecasting frequency and quality in line with the baseline findings, which strongly suggests political ideology played a role.

Gao explains the disparity by pointing to what the paper calls a "precautionary effect" at work in the minds of conservative chief executives.

Since right-leaning leaders are traditionally seen as more risk-averse, it stands to reason that they would use forecasts to manage market expectations and avoid the negative consequences of disappointment. This theory is supported by the observation that firms with high institutional ownership and litigation risk—in other words, firms exposed to a harsher spotlight—displayed even more careful forecasting behavior when led by a conservative CEO.

Still, Gao cautions against making broad assumptions about Democrat and Republican CEOs on the basis of his findings. For one thing, the current study concentrates only on CEOs with distinctly right-wing leanings rather than comparing partisan apples to apples. Gao says, "I know polarization has been really bad in recent years. I'm not trying to stand on one side and critique the other one. It's more like a proxy for conservativeness than conservatism per se; that's why we used this variable."

But Gao insists that his paper, however nuanced, proves the need for further research on how political ideology motivates business decisions. "CEOs' political ideology can shape policies of companies, disclosure policies specifically. There aren't a whole lot of papers looking at this. Politics are very important. First-order, in many cases."

More information: Ahmed Elnahas et al, CEO Political Ideology and Voluntary Forward-Looking Disclosure, *Journal of Financial and Quantitative Analysis* (2023). DOI: 10.1017/S0022109023001023

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