Living up to Analyst Expectations: A Quantitative Analysis of Corporate Short-Termism*

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Abstract

Do managers prioritize short-term gains over the long-term health of their companies? I explore this question by examining how external analyst forecasts causally influence managerial decisions around earnings. I measure the change in the composition of analyst 'fixed effects' induced by brokerage mergers, and use this as a source of exogenous variation in consensus forecasts. I find that firm-level earnings respond to sell-side analyst forecasts in a one-to-one fashion. I find that this earnings response is driven by accruals, consistent with earnings management on the part of short-termist managers, and that the market views these accruals as costly. To estimate the cost of this short-termism, I develop a simple model that: (i) rationalizes forecast-dependent earnings management, and (ii) provides a framework for structurally estimating short-termism in the data. I find that short-termism is a significant feature of the US public firm environment, and very costly: moving to no short-termism is associated with an increase in the average earnings-per-share of 0.47 standard deviations.

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