

The Reliability of Management Earnings Forecasts in IPO Prospectuses: A Study of Managers' Forecasting Preferences

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Abstract : This study investigates the reliability of management earnings forecasts with reference to these two ingredients: verifiability and neutrality. Specifically, we examine the biasedness (or accuracy) of management earnings forecasts and company specific characteristics that can be associated with accuracy. Based on sample of 102 IPO prospectuses published for admission on NYSE Euronext Paris from 2002 to 2010, we found that these forecasts are on average optimistic and two of the five test variables, earnings variability and financial leverage are significant in explaining ex post bias. Acknowledging the possibility that the bias is the result of the managers' forecasting behavior, we then examine whether managers decide to under-predict, over-predict or forecast accurately for self-serving purposes. Explicitly, we examine the role of financial distress, operating performance, ownership by insiders and the economy state in influencing managers' forecasting preferences. We find that managers of distressed firms seem to over-predict future earnings. We also find that when managers are given more stock options, they tend to under-predict future earnings. Finally, we conclude that the management earnings forecasts are affected by an intentional bias due to managers' forecasting preferences.

Keywords : intentional bias, management earnings forecasts, neutrality, verifiability

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