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The Role of Managers' Expectations Stickiness in Changing the Information Content of Earnings[1]

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Research Paper

INTRODUCTION

Theorists developed expectations-based research to explain the formation of power and credibility frameworks in functional groups. Expectancy theories describe the distribution of influence and power within a group using the concept of performance expectations, which are predictions of future performance relative to group tasks. Performance expectations enable group members to compare themselves to others. When a person forms performance expectations, they can evaluate and compare their situation by predicting favorable actions within the group. However, these expectations are rarely expressed explicitly and are often formed subconsciously. Performance expectations are shaped by group members and shared among other interacting members, thus serving as the basis for organizing each member's activities. A tendency to react less than expected to receive news and information may indicate a behavioral bias in managers' responses to new economic conditions. As a result, managers may limit adjustments to previous forecasts due to expectations stickiness. This article aims to investigate the role of managers' expectations stickiness in changing the information content of current profits.

MATERIALS AND METHODS

Since the research results can be applied to the decision-making process, this study is classified as applied research based on its purpose. Applied research seeks to develop practical knowledge in a specific field. Additionally, based on the data collection method, this research is descriptive. Descriptive research may aim solely to enhance understanding of existing conditions or to assist in decision-making processes.

Among the various types of descriptive research, this study is correlational. For this purpose, data from 120 companies listed on the Tehran Stock Exchange, covering the period from 2011 to 2022, were extracted, and a pooled data regression model was used to test the research hypotheses. To calculate managers' expectations stickiness, an earnings forecasting approach was employed.

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RESULTS AND DISCUSSION

This research examines the role of managers' expectations stickiness in altering the information content of earnings. The findings indicate that managers' expectations stickiness was observable in the studied companies. Managers with high self-expectations are less likely to exhibit collectivist tendencies compared to other managers. This approach highlights the impact of sticky expectations on changing future outcomes and predictions. Additionally, managers' expectations stickiness contributes to an increase in earnings anomalies. Earnings anomalies occur when managers update their expectations of future earnings too slowly. Managers are expected to revise their projected future earnings based on their understanding of the company's conditions and risks. Finally, the results of the third hypothesis reveal a significant relationship between managers' expectations stickiness and the information content of current earnings. Due to under-reaction to received news and information, managers' expectations stickiness reduces the information content of current earnings. Investors vary in their abilities and models for processing and analyzing earnings-related information. Consequently, managers' stickiness and under-reaction, combined with deviations in future earnings, can increase ambiguity in the analysis and interpretation of information in financial markets.

CONCLUSION

Managers' expectations stickiness reduces their tendency to adjust forecasts and respond appropriately to new information. This delay and under-response, stemming from prior expectations, decreases the reliability of current earnings and diminishes their information content for predicting future activities. According to the research findings, managers' expectations stickiness leads to dispersion and deviation in future profits, potentially increasing the risk of adverse selection for market participants. In other words, incorporating managers' expectations stickiness into decision-making models can provide a basis for predicting deviations in future profits. This information can enhance the accuracy of capital market analysts' forecasts.

To further refine the research results, it is recommended to explore the interactive effects of paid bonuses and managers' optimism on expectations stickiness. Additionally, to better understand market behavioral approaches, the effects of product diversity and the level of competition in the capital market could be examined.

This research has limitations, including the approach to measuring managers' expectations stickiness. Since managers' behaviors and reactions are influenced by internal and personality traits that cannot be directly observed or measured, caution is advised when generalizing the results.

Keywords: Managers' Expectations Stickiness, Earning Anomaly, Information Content of Earnings.

JEL Classification: M41.