University of Antwerp - Harvard Law School - ECGI Conference

Short-termism in European Corporate Governance
Quarterly Reporting – Is less actually more?

May 30, 2023

Dr. Kim Willey, B.A. (Hons), LL.B, M.B.A, LL.M, PhD
Email: kwilley@uvic.ca

Agenda

1. What is quarterly reporting?
2. UK, US and EU Requirements
3. Rationale for UK/EU reforms
4. Continued interest in reform
5. Is quarterly reporting short-termist?
6. If so, will the reforms be effective?
7. Concluding remarks

What is Quarterly Reporting?

- Quarterly report is a summary of unaudited financial statements issued quarterly (every 3 months) and filed publicly for stock exchange listed-companies
- Meant to assist asset owners (i.e., investors) make prudent investment decisions

UK, US and EU Requirements

Jurisdiction	Reporting	Details
United States	S.E.C Form 10-Q	Filed at end of first 3 quarters and includes unaudited financial statements and operational information for prior quarter. *Many 10-Q filing companies also voluntarily publish earnings releases, hold earnings calls, and/or issue earning projections
United Kingdom	Quarterly reporting optional since 2014	FCA Handbook; Disclosure and Transparency Rules only require annual, and half year financial reports
European Union	Quarterly reporting optional since 2013	Directive 2013/50/EU amending the Transparency Directive (Directive 2004/109/EC) – member states only require annual, and half year financial reports. *Some EU stock exchanges require quarterly reporting

Rationale for UK/EU reforms

- Prof. John Kay recommended UK mandatory quarterly reporting be removed in order to reduce perceived pressures for short-term decision-making arising from excessive – e.g., quarterly – reporting of financial performance (Source: Kay Report (2012))

- In the rationale for removing quarterly reporting the EU Parliament/Council stated, "[i]n order to encourage sustainable value creation and long-term oriented investment strategy, it is essential to reduce short-term pressure on issuers and give investors an incentive to adopt a longer-term vision" (Source: Directive 2013/50/EU (EU Transparency Directive)

Continued interest in reform

- 2018 SEC Request for Comment on Earnings Releases and Quarterly Reporting (Release Nos. 33-10588, 34-84842), recent comments supportive of (reduced) tri-annual reporting (https://www.sec.gov/rules/other/2018/33-10588.pdf)
- Increasing number of UK listed companies moving from quarterly to semi-annual reporting (2016 – FTSE 100 (70 to 57), FTSE 250 (111 to 83))*
- EU Commission Report in 2020 considering reforms to discourage or prohibit quarterly reports (https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en)

* Source: Owen Walker, The Long and Short of the Quarterly Reports Controversy, Financial Times (July 1, 2018)

Is quarterly reporting short-termist?*

- Perceived problem is that ***investors value short-term financial returns over potentially more profitable longer-term investment opportunities***.
- Investors/intermediaries may be 'impatient' and unduly react to quarterly reports – i.e., sell shares and negatively impact share price – causing companies to produce positive short-term results at expense of long-term investments.
- But there are evidentiary issues inherent in viably identifying and measuring short-termism harms.

* Source: Willey, Kim M, Stock Market Short-Termism: Law, Regulation and Reform (Palgrave MacMillan: 2019) (forward by Martin Lipton)

If so, will the reforms be effective?*

- Even if we accept that short-termism is harmful, to correct the issue, reforms to quarterly reporting must either:
  1. reduce actual or perceived discounting of future returns by 'enlightening' investors on the potential harms of a short-term bias; or
  2. cut off the transmission of investor short-termism into listed companies by: (a) insulating managers; AND (b) reducing short-term compensation of managers.

* Source: Willey, Kim M, Stock Market Short-Termism: Law, Regulation and Reform (Palgrave MacMillan: 2019) (forward by Martin Lipton)

If so, will the reforms be effective? Cont.*

Pathway 1 – End of mandatory quarterly reporting may act to 'improve' or 'enlighten' investors (and asset managers) by forcing a longer-term approach. But impact may be minimal as reforms are voluntary, and not in place in the US and certain EU stock exchanges. Outright prohibitions on quarterly reporting could be more effective, but unlikely to be justified given evidentiary issues on the harms of short-termism.

Pathway 2 – End of mandatory quarterly reporting could assist with insulating company management from short-term pressures but would not be effective in the absence of restrictions on executive compensation based on quarterly metrics.

* Source: Willey, Kim M, Stock Market Short-Termism: Law, Regulation and Reform (Palgrave MacMillan: 2019) (forward by Martin Lipton)

Concluding Remarks

- Considerable interest in removing quarterly reporting/earnings guidance.
- But…hard evidence of short-termism harm is inconclusive.
- Further analysis is needed, particularly in comparing investments in R&D, year to year consistency of earnings/revenues, and ESG measures between entities that opt for quarterly reporting verses those that provide semi-annual reporting.
- Timing of quarterly reporting cannot be viewed in isolation from quality of reporting and other measures to reduce short-termism concerns, such as executive compensation.
- In the meantime, there may be strong policy reasons to remove or restrict quarterly reporting/earnings guidance (i.e., reduce regulatory burden, improve quality of information, etc.), but the short-termism rationale is largely rhetoric, and removal of such reporting should also be weighed against potential impacts to capital market liquidity/efficiency.