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RESEARCH NOTE

#PARG 2020-03RN

Firm Perspective on Impression Management in Earnings Press Releases: Insights from TSX Venture Exchange Firms

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Firms use various corporate disclosure documents to communicate valuable incremental information to their investors about the firm's performance. Firms also use these documents opportunistically to manage or influence the perceptions of investors. This opportunistic behavior of firms in their disclosure documents is often referred to as impression management, which is a rapidly growing field of research in accounting. However, there is still little known about impression management practices of small, low-visibility firms. Moreover, there is lack of research on retail investors' direct attention to impression management strategies as prior research has mainly focused on stock market reaction.

This study[1] analyzes several impression management strategies in the earnings press releases of TSX Venture Exchange firms to investigate whether, and how, low-visibility firms engage in impression management. It also explores the investor reaction to impression management strategies by supplementing stock market reaction with online investment discussion board reaction. This note is part of a sequence of three research notes. The first note (#PARG 2020-02RN) is about impression management strategies. The second note (#PARG 2020-03RN) is about firm perspective on impression management and provides findings on impression management practices of TSX Venture Exchange firms. The third note (#PARG 2020-04RN) is about investor perspective on impression management and shares findings on the consequences for investors of the use of various impression management strategies.

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TSX Venture Exchange and low-visibility firms

Canada's natural resources are responsible for a significant portion of the country's GDP and account for 1.74 million Canadian jobs directly and indirectly (Statistics Canada, 2017a, 2017b). While Canadian mining and energy firms play a crucial role in the process of extracting economic value from the country's vast natural resources, these firms largely depend on Canadian stock exchanges to finance their operations. With nearly 60% of global mining financing and over $18 billion in equity capital raised for energy firms, the TSX Venture Exchange and the TSX stock exchange are global leaders in providing access to capital for natural resource firms (TMX Group, 2018). In terms of the number of issuers, the TSX Venture Exchange accounts for over 80% of overall mining companies and more than 62% of energy companies that are listed on the two Canadian exchanges (TMX Group, 2018). Although the TSX Venture Exchange has over 1,600 listed companies and $51 billion market value (TMX Group, 2018), it has not received any noteworthy interest from accounting and finance academics.

The TSX Venture Exchange is one of the leaders in providing opportunities to raise equity capital for emerging, small and less visible companies from 14 sectors of the economy. It is estimated that the average market capitalization of listed companies on the TSX Venture exchange is $30.7 million (TMX Group, 2018). TSX Venture firms can be characterized as less visible firms since these firms exhibit the main characteristics of less visible firms - small market capitalization, low liquidity, low analyst following, and less prominent exchange listing (Bushee and Miller, 2012). Such characteristics of TSX Venture firms make them a valuable venue of research to study how firms listed on this exchange present information in their disclosure documents. More particularly, studying TSX Venture Exchange firms can help understand whether low-visibility firms engage in certain practices in their disclosure documents to attract investors' attention and manage investors' perceptions.

Overall, there is lack of research to understand impression management practices of low-visibility firms. Several studies conclude that less visible firms are more likely to take advantage of private information since there is generally insufficient information available to investors to monitor firms' actions (Elliott, Morse and Richardson, 1984; Schipper, 1989). Therefore, less visible firms can more successfully influence the perceptions of the readers of their disclosure documents (Blankespoor, Miller and White, 2013; Bhagwat and Burch, 2016; Bartov, Faurel and Mohanram, 2017). Some existing impression management studies have included some firms with low-visibility characteristics in their samples, but these studies do not provide generalizable findings on the impression management practices of low-visibility firms. As a result, there is little known about the impression management practices of low-visibility firms specifically. The objective of this investigation is to shed light on the impression management practices of low-visibility firms. This research can benefit accounting professionals, financial regulators, and academic researchers, as well as lead to increased attention to TSX Venture Exchange firms.

Research questions

This study uses a sample of 1,317 earning press releases (EPRs) by 145 TSX Venture firms to explore impression management by low-visibility firms in their EPRs. To better understand whether and how (using which strategies) TSX Venture firms engage in impression management in their EPRs, the study sought answers to the following research questions:

1. Does firm performance affect the likelihood of engagement in impression management strategies by TSX Venture firms?
2. What are the prevalent impression management strategies used in the EPRs of TSX Venture firms?
3. What are the characteristics of TSX Venture firms that use certain impression strategies?

Findings

To determine whether TSX Venture Exchange firms engage in impression management, associations between firm performance and impression management strategies were examined. It was found that TSX Venture firms engage in all the impression management strategies studied to some extent. More specifically, results indicate that firms manage reading complexity and causal reasoning intensity of EPRs based on firm performance. Firms also manage EPR tone by inflating it so that it cannot be explained by future financial performance. Moreover, headline impression management results indicate that firms highlight positive performance by thematically manipulating topics, reinforcing performance, and repeating performance figures in EPR headlines. These results collectively confirm that firm performance does impact the level of engagement in impression management strategies by TSX Venture Exchange firms.

Results show that readability and causal reasoning manipulation strategies are most predominant among the impression management strategies investigated. The associations of these two impression management strategies with firm performance are stronger than the other strategies. The analysis of the EPRs of TSX Venture Exchange firms indicates a strong negative relationship between financial performance and the two related readability measures - reading complexity and causal reasoning intensity. Though not to the same extent as the readability measures, abnormal tone and headline impression management measures are also related with firm performance. The abnormal tone measure increases when firm performance decreases, whereas headline impression management measures increase when firm performance increases. These relationships are expected because tone management is based on masking poor performance by artificially lifting tone, while headline impression management is based on highlighting strong performance. Moreover, findings from headline impression management show a widespread use of this strategy among TSX Venture Exchange firms. That is, 42% of firms positively emphasized performance in the headlines of their EPRs, while only 2% highlighted negative performance.

The most influential firms characteristic affecting firms' engagement in impression management is industry. Natural resource (Oil & Gas and Metals & Mining) firms are similar regarding their use of impression management, and they use much less impression management than firms in other industries. Similarities between the two natural resource industries may be explained by the concept of mimetic isomorphism. According to this concept, given the prevalence of a practice and behavior in an industry, firms try to adopt the practices of successful firms within the industry (Haveman, 1993). Therefore, since there are many ways of preparing EPRs, which are voluntary in nature, it is possible that many Metals & Mining and Oil & Gas firms are following successful firms within the overall natural resource industry. Less engagement in impression management by natural resource firms may be because they are more likely to deal with more precise estimates (e.g., barrels of oil, ounces of gold) than other industries, leaving less room for tone management. Moreover, this study used 'change in operating income' as a performance measure to investigate firms' use of impression management strategies. Although the final sample in this study comprises frequent EPR-issuers (firms issuing quarterly EPRs), certain junior mining companies in the natural resource industries may be more interested in managing the impressions of investors around exploration operations (i.e., successful drilling programs) than financial performance.

Another important finding about firm characteristics is that there is a higher level of tone management by smaller firms in the sample. This is consistent with prior literature that smaller firms are more likely to engage in impression management (Davis and Tama-Sweet, 2011; Bhagwat and Burch, 2016). However, reading complexity and headline impression management results show contradictory results as the effects of these two impression management strategies are more pronounced when firms are larger. Unlike tone management, readability manipulation involves managing the syntactical complexity of disclosures and requires more time and care. To prepare disclosures that communicate information by employing techniques of readability manipulation, firms usually hire professional outside agencies (Merkl-Davies and Brennan, 2007). Since it is not mandatory to employ outside professional agencies to prepare EPRs, it is possible that larger firms with more financial resources are more likely to do so. Moreover, Courtis (2001) argues that larger and older firms are more likely to have established sophisticated information and communication systems and to employ specialized consultants to prepare their disclosures. Perhaps, greater headline impression management can also be explained by the higher likelihood of larger firms using professional agencies, whose experience is used to emphasize positive performance.

Implications

This study has several practical implications. Findings of this study may be of interest to accounting professionals when working with public firms and government agencies. For example, Chartered Professional Accountants (CPA) may want to include information on impression management strategies used by low-visibility firms in their curriculum for teaching management teams about business values and ethics. Evidence from this study suggests that TSX Venture firms obfuscate performance results by managing the tone and/or manipulating the readability features of disclosure content, which could mislead investors. Although firms are allowed exercise a great level of freedom when preparing their voluntary disclosures, certain ethical considerations should be taken into account by firms when deciding whether to engage in impression management. These considerations are essential for maintaining firms' commitment to such business values as integrity, honesty, and accountability.

Accounting professionals who work with/at government agencies and publicly traded firms may also find this study beneficial. Impression management practices of TSX Venture Exchange firms may be of interest to financial regulators who are concerned about unfair use of disclosure documents. For example, regulators may find it necessary to take some measures against opportunistic disclosure practices in the headlines of EPRs. Results of this study show that good and bad performers do over- and under-emphasize financial results in the headlines of their EPRs, respectively. Therefore, financial regulators may want to eliminate or reduce the effect of such actions by low-visibility firms that can potentially bias the perceptions of EPR readers. Similarly, when helping with the preparation of voluntary disclosure documents for public firms, professional accountants may counsel against opportunistic use of EPR headlines. That is, firms should be encouraged to highlight both good and bad performance to the same extent.

Lastly, this research may also benefit academics by increasing their awareness of low-visibility firms, in particular, TSX Venture Exchange firms which play an important role in the Canadian economy. Thanks to the breadth of this analysis, which covers many research areas (e.g., firm visibility, corporate disclosures, impression management, investor reaction), this study can serve as a basis for future research on TSX Venture Exchange firms extending beyond just impression management. In addition to investigating multiple impression management strategies, this research also explores the consequences of impression management in the analysis of the investor perspective which is covered in the final part of this sequence of discussion briefs.

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[1] Mansurov, Alisher. (2019). *Investor and Firm Perspectives on Impression Management in Earnings Press Releases: Insights from TSX Venture Exchange Firms*. (Doctoral Dissertation). Sprott School of Business, Carleton University, December. URL: https://carleton.ca/profbrouard/wp-content/uploads/ThesisPhDAlisherMansurov201912.pdf