Go Tell It on the Internet: Twitter Effects on Expectations Management

Emergent Research Forum (ERF)

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Abstract

Former United States Securities and Exchange Commission (SEC) Commissioner Norman S. Johnson expressed the single most important cause of earnings management is “the pressure imposed on management to meet analysts’ earnings estimates” (Johnson 1999). He and former chairman of the SEC, Arthur Levitt, also commented on the severity with which the market punishes companies failing to meet analysts’ expectations. Levitt suggests the motivation to meet earnings expectations overrides “common sense business practices” (Levitt 1998). Firms employ multiple strategies to avoid negative impacts to firm valuation and to meet or exceed analysts’ forecasts (Bartov and Cohen 2009).

Additionally, firms are increasingly motivated to use social media as a channel for disseminating financial news to market participants. In 2008, less than 5% of S&P 1500 companies reported using social media to communicate financial news; by 2013, 47% of S&P 1500 companies had adopted Twitter and 44% had adopted Facebook for this purpose (Jung et al. 2017). Following a social media post containing significant financial information by Netflix’s CEO, Reed Hastings—which was attributed to a 16% increase in stock price—the SEC released a clarification to Regulation Full Disclosure in 2013. The SEC announced companies and corporate officers may use social media to disseminate financial news to investors provided the information is made public and investors are notified where to find the information (U.S. SEC 2013).

Given these changes to the use and adoption of social media, we investigate whether social media, specifically Twitter, provides a new tool to guide analysts’ forecasts to meet or exceed earnings expectations. We explore whether variations in the timing, amount, and valence of corporate Twitter posts significantly affect a company’s ability to influence—and thereby meet or beat—analysts’ expectations.

To address this research question, we focus on earnings forecasts made by analysts during the quarter and collect financial news released via corporate accounts on Twitter. Tweets—Twitter posts—and financial data are collected over the six quarters ending between January 2015 and June 2016 to ascertain whether there are relationships in the frequency, amount, and valence of tweets with changes in analysts’ expectations. Our preliminary analysis finds a significant positive relationship between the change in analysts’ forecasts and the number and valence of relevant tweets. This suggests guidance firms—those guiding analysts’ forecasts downward to beat earnings expectations—use social media to lower earnings forecasts.

We believe our research makes two significant contributions. First, we document the use of Twitter to manage analysts’ expectations. This provides investors additional insight into the strategic use of Twitter to meet or exceed analysts’ forecasts. Second, our research design incorporates a propensity score matching model to isolate the effect of Twitter activity to determine whether there are greater incentives for firms to strategically disseminate relevant financial news, regardless of its valence (positive or negative), to ensure market participants have the information needed to accurately assess firm value.

Keywords

Expectations management, forecast guidance, strategic dissemination, Twitter