The Effect of Voluntary Disclosure on Firm Risk and Firm Value: Evidence from Management Earnings Forecasts

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Abstract:

This study investigates whether the voluntary disclosure of management earnings forecasts influences investors' assessment of firm risk and firm value. We find a significant negative relationship between the issuance of management earnings forecasts and a variety of measures of firm risk (idiosyncratic risk, stock return volatility, beta, and bid-ask spreads), with more frequent, more precise and more accurate earnings forecasts further decreasing firm risk. Our results therefore suggest that information quality is an important determinant of both diversifiable risk and nondiversifiable systematic risk. We also demonstrate that management earnings forecasts are positively associated with firm value as captured by Tobin's Q while more frequent, precise and accurate forecasts further enhance valuation premiums. Finally, we find that management earnings forecasts impact firm value not only through a reduction in firm risk, but also through changing investors' perceptions about future cash flows. Our results are robust to various sensitivity checks. Overall, releasing high-quality management earnings forecasts is associated with important capital market benefits.