

Research on CEO Individualism and Management Forecasts

Jingyue Zhang*

School of Management Science, Chengdu University of Technology, Chengdu, China

*Corresponding author: 136040714@qq.com

Keywords: Cultural background, CEO individualism, management forecasts, corporate governance.

Abstract: In this study, I examine the impact of CEO individualism on management forecasts (MFs) based primarily on individualism data collected by Hofstede [1]. I found that CEO individualism influences a company's decision whether to make MFs voluntarily as well as the tone of information disclosures. In addition, cross-sectional tests showed that firms with poor corporate governance were more likely to be influenced by informal aspects of corporate culture, including individualism, when making MFs. Overall, I demonstrate here the significance of taking into account information related to CEOs' individualism when assessing the accuracy of the information presented in MFs.

1. Introduction

Culture has received relatively little attention as a quantitative factor in business management behaviour in proportion to its impact when it comes to constructing a sense of collective orientation and shared meaning for companies in their day-to-day operations and as they develop [2, 3]. Individualism (as opposed to collectivism) is, by definition, a value centred on the individual [4] and, as such, influences the propensity of companies to release comprehensive reports that include financial and predictive information [5]. In addition, management forecasts (MFs) are important for the disclosure of the corporate information that plays a significant role in the cross-sectional setting of a company's decisions [6, 7]. Therefore, businesses can benefit from identifying the factors that may contribute to MFs. In this article, I examine the role of voluntary MFs, positive tone in management forecasts in relation to the individualism of CEOs.

2. Development of the hypotheses

Signalling theory provides a theoretical basis for understanding the influence of CEOs' individualistic traits on MFs. When the incentive to report the truth regarding an issue through traditional signalling codes is weak, alternative ways of delivering information become necessary [8]. CEOs with individualistic traits tend to be more impulsive [9] than those without such traits and more likely to volunteer an MF and to disclose more information therein. Individualism taken to extremes becomes narcissism, an aggressive and inflated perception of the self that is nevertheless an elemental psychological attribute related to CEOs' decision-making and the results that they achieve for their companies [10]. Management talent signalling serves as a motivation for competent and assertive CEOs to issue MFs voluntarily [11], while their narcissism correlates positively with their willingness to issue MFs [12]. I accordingly hypothesized that individualism, which is related to impulsiveness and narcissism, enhances the willingness to issue an MF:

H1: Its CEO's level of individualism influences a company's engagement in voluntary management forecasting.

A CEO's personality, such as a tendency towards optimism or pessimism, naturally has a significant impact on the tone of his or her disclosures [13]. Individuals with pronounced individualistic traits tend to be especially optimistic and self-referential, characteristics that predispose them to control the message regarding potential earnings [12]. CEOs with narcissistic traits tend to disclose good news more readily than bad news—and to base their projections of future company profitability on expectations rather than actual performance as well as to manage their

companies with less responsiveness to corrective feedback [14]. These tendencies culminate in the tendency to produce MFs that are inaccurate in terms of being more optimistic than performance indicates [15]. I therefore hypothesized that individualistic CEOs, being narcissistic, are more likely than CEOs who are not individualistic to produce optimistic MFs:

H2: The tone of MFs issued by CEOs who display individualistic characteristics tends to be optimistic.

Figure 1 presents a conceptual overview of the approach taken in this research.

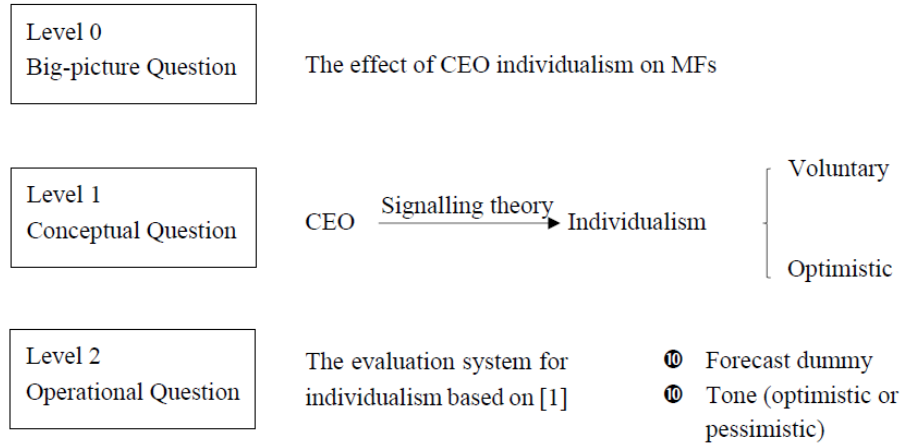


Figure.1. Libby's box [15]

3. Research design

3.1 Model specification

I estimated a regression equation following [12] in the following form to test the MFs:

$$\begin{aligned}
 & Disclosure\ Attributes_{m,i,t} \\
 & = \alpha_0 + \alpha_1 Individualism_m + \sum \beta Manager\ Control_{m,t} \\
 & + \sum \gamma Firm\ control_{i,t} + \sum \delta Country\ Control_{i,t} + IndustryFE + YearFE \\
 & + \varepsilon_{m,i,t}
 \end{aligned} \tag{1}$$

Where m is the manager index, i is the firm index, and t is the management forecast quarter. I focussed on α_1 , which was the main variable for determining whether the CEO's individualistic traits had an impact on the company's disclosure attributes. Industry FE and Year FE, the dummies for industry and year, respectively, served to control for unobservable time-invariant and firm-invariant factors. I analysed in two dimensions whether CEOs with individualistic traits were proactive in their disclosures and whether their disclosure statements were optimistic in tone. In addition, I devised controls for certain features of management known to affect the disclosure of information [16], including CEOs' competence, company size (Size), and governance structure. Thus, I treated the manager as well as the firm as control variables. I also included a country factor because the policies governing disclosure by companies vary from country to country, with some mandating disclosure and others leaving it to the companies' discretion [17].

3.2 Variable measurements

(1) Individualism

I applied Kerr's ethnic-name matching method [18] to relate the characteristics of CEO individualism to ethnicity-level indices of individualism and adapted the methodology of [1] to measure CEOs' levels of individualism. The data for the sample were the average scores of employees' satisfaction with work and life from 2002 to 2012; the sample included 88,000 employees in 72 countries [12]. Table 1 shows some of the data for the CEOs' surnames from conference calls

matched with ethnicity. Table 2 presents the context of the managers' individualism across nine ethnic groups as an ethnic dimension for study. Panel A of Table 2 presents a comparison of the degree of individualism across the ethnic groups. Members of the Korean and Chinese ethnic groups displayed the lowest levels of individualism while Anglo-Saxons displayed the highest levels. Panel B presents the geographical distribution of the managers by company region (British, European, Japanese, Indian, Swiss, Spanish, Chinese, or Korean). The largest portions of CEOs were those whose ethnicity corresponded to the location of their companies (bold figures in Panel B). Thus, the preliminary statistics showed variation between the location of a company and its CEO's origin.

Table. 1 Top Five Surnames of Managers Speaking during Conference Calls by Ethnic Group

Managers' Ethnic Group	Chinese	Anglo-Saxon	European	Indian/South Asian	Hispanic/Filipino	Japanese	Korean	Russian/Slavic
1	Chen	Smith	Schwartz	Shah	Garcia	Tanaka	Kim	Kaminski
2	Wang	Johnson	Schmidt	Patel	Lopez	Suzuki	Park	Brodsky
3	Wong	Miller	Weiss	Singh	Sanchez	Kato	Choi	Lasky
4	Chan	Brown	Meyer	Kumar	Fernandez	Santo	Cho	Khaykin
5	Li	Jones	Wagner	Gupta	Perez	Takahashi	Jung	Radinsky

Table.2 Descriptive Statistics of Managers' Cultural Background Based on Ethnicity

Panel A: Distribution of Managers' Ethnic Groups

Cultural Background	Variation	Individualism Measure (×100)	# of Managers	% of Managers with Ethnic Cultural Background Consistent with the Firm's Region
Anglo-Saxon	ENG	89.51	16.831	77%
European	EUR	65.76	4.156	48%
Japanese	JAP	46	174	44%
Indian/South Asian	IND	42.16	754	67%
Russian/Slavic	RUS	39	428	53%
Hispanic	HIS	33.16	1,523	69%
Chinese	CHN	20.41	899	64%
South Korean	KOR	18	135	77%
Total			24.901	74%

Panel B: Distribution of Managers' Ethnic Groups by Region in which Their Firms Were Located

Firm Region\Manager's Ethnic Group	ENG	EUR	JAP	IND	RUS	HIS	CHN	KOR	Total
U.S., U.K., Australia, New Zealand, Canada, South Africa	78%	13%	0%	2%	1%	3%	3%	0%	100%
Europe	36%	48%	0%	1%	2%	11%	1%	0%	100%
Japan	37%	6%	44%	2%	2%	3%	4%	2%	100%
India, Bangladesh, and Pakistan	22%	4%	0%	67%	2%	3%	1%	0%	100%
Russia/Slavic	44%	2%	0%	0%	53%	0%	0%	0%	100%
Hispanic nations	18%	11%	0%	0%	1%	69%	0%	0%	100%
China, Hong Kong, Singapore, and Taiwan	21%	3%	1%	6%	0%	4%	64%	2%	100%
South Korea	3%	0%	0%	0%	4%	1%	14%	77%	100%

(2) Management forecast

I used indicator variables and the forecast frequency to measure the companies' voluntary disclosure tendency and a good news management forecast dummy (*GMFD*) and a bad news management forecast dummy (*BMFD*) to measure the positive or negative tone forecast made by management forecast.

Table.3. Definitions of the Variables

<i>Variables</i>	<i>Definition</i>
<i>Dependent variables</i>	
<i>MF</i>	An indicator variable coded as 1 when the company voluntarily provided at least one management forecast in year t and 0 otherwise.
<i>Freq</i>	The number of management forecasts in a financial year.
<i>GMFD</i>	A positive dummy variable coded as 1 when the predicted value was greater than the true value and 0 otherwise.
<i>BMFD</i>	A negative dummy variable coded as 1 when the predicted value was less than the true value and 0 otherwise.
<i>Independent variables</i>	
<i>Individualism</i>	Hofstede's (2001) average of national-level indices of individualism by ethnicity (https://geerthofstede.com/research-and-vsm/vsm-2013/)
<i>Control variables</i>	
<i>CEO</i>	This indicator is coded as 1 when the manager was the chief executive officer and 0 otherwise.
<i>Size</i>	The size of the business was measured as the natural logarithm of the book value of gross assets in the year t.
<i>Disclosure Requirement</i>	This indicator was developed by La Porta et al. (2006) to indicate whether a country requires prospectuses to be filed with potential investors and positive disclosure requests in five domains

The sample represented the period from 2002 to 2012. Individualism data were taken from [1], and the management forecast data were among the management earnings forecast (MEF) data from the company-issued guidelines (CIGs) in Thomson Financial's First Call Historical Database (FCHD). The control variables used data from COMPUSTAT in WRDS.

4. Expected empirical results

4.1 Hypothesis test

I expected that the individualism index would correlate positively with both a preference for voluntary disclosure and a more positive tone in disclosures of information in MFs.

4.2 Cross-sectional test: corporate governance effect

To investigate further the impact of individualism on the MFs of various types of firms, I distinguished well-governed and poorly governed firms, with the expectation that the latter would be more affected by individualism since companies with good corporate governance are less supportive of individualistic behaviours [19]. Because corporate governance has a significant positive effect on the disclosure of corporate information [7], good governance attenuates the impact of other informal factors on companies' performance. I accordingly predicted that individualism would have less of an impact on companies with good corporate governance than on companies with poor corporate governance.

(1) Robustness tests

I conducted several tests to assess the robustness of my results. First, I used an alternative measurement of individualism to test whether the hypotheses would hold and repeated the analysis using the individualistic component attributed to genetics. Second, to mitigate sample-selection bias,

I applied the 1:1 nearest propensity score matching (PSM) method using the matching variables of firm size, ROA, leverage, leverage, earnings volatility, and firm industry. Lastly, I extended other regression specifications, such as the change model and firm fixed effects model, to mitigate issues associated with the omitted variable endogeneity.

5. Conclusions

I expected that CEO's individualism would influence companies' decisions regarding whether to issue voluntary MFs and that such MFs would display a positive tone with respect to disclosure. The findings presented here have several practical implications. To begin with, public limited companies can benefit from recognizing the significance of information integration so that stakeholders and analysts alike can use the information that CEOs disclose when assessing the quality and accuracy of their reporting and avoid the overly optimistic understanding of companies' true situations that individualistic CEOs tend to promote. Further, the impact of individualism on MFs tends to correlate negatively with the strength of internal and external rules and oversight, a fact that investors should keep in mind when assessing the trustworthiness of management forecast reports.

The present study, like all studies, is subject to limitations. In particular, the measurement of individualism based on ethnicity may be suspect because it took into account only nine categories. Moreover, measurement errors may have been introduced in the replacement of individualism with ethnicity. Likewise, since the locations of the various ethnicities did not represent the CEOs' permanent places of residence, their ethnicity cannot be considered as representative of their culture.

References

- [1] Hofstede, G.H. (2001). *Culture's Consequences: Comparing Values, Behaviors, Institutions and Organizations Across Nations*. Sage Publications, CA.
- [2] House, R., Wright, N. S., & Aditya, R. N. (1997). Cross-cultural research on organizational leadership: a critical analysis and proposed theory. In P. C. Early & M. Erez (Eds.), *New perspectives on inter- national industrial/organizational psychology* (pp. 535–625). Lexington Press.
- [3] Stojanović, E. T., Vlahović, M., Nikolić, M., Mitić, S., & Jovanović, Z. (2020). The relationship between organizational culture and public relations in business organizations. *Journal of Business Economics and Management*, 21(6), 1628-1645.
- [4] Goncalo, J. A., & Staw, B. M. (2006). Individualism–collectivism and group creativity. *Organizational Behavior and Human Decision Processes*, 100(1), 96-109.
- [5] García-Sánchez, I.-M., Rodríguez-Ariza, L., Frías-Aceituno, J.-V. (2013). The cultural system and integrated reporting. *Int. Bus. Rev.* 22 (5), 828–838.
- [6] Huang, K. (2020). Management forecast errors and corporate investment efficiency. *Journal of Contemporary Accounting & Economics*, 16(3), 100-208.
- [7] Brockman, P, Khurana, I. K., Martin, X. (2008). Voluntary Disclosures Around Actual Share Repurchases[J]. *Journal of Financial Economics*, 89(1):175-191.
- [8] Spence, M. (1973). "Job Market Signaling", *The Quarterly journal of economics*, vol. 87, no. 3, pp. 355-374.
- [9] Sims, T., Tsai, J. L., Jiang, D., Wang, Y., Fung, H. H., & Zhang, X. (2015). Wanting to maximize the positive and minimize the negative: implications for mixed affective experience in american and chinese contexts. *Journal of Personality and Social Psychology*,109(2), 292-315.
- [10] Kim, B., Lee, S., & Kang, K. H. (2018). The moderating role of CEO narcissism on the relationship between uncertainty avoidance and CSR. *Tourism Management* (1982), 67, 203-213.

- [11] Healy, P. M., & Palepu, K. G. (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting & Economics*, 31(1), 405-440.
- [12] Brochet, F., Miller, G. S., Naranjo, P., & Yu, G. (2019). Managers' cultural background and disclosure attributes. *The Accounting Review*, 94(3), 57-86.
- [13] Davis, A. K., W. Ge, D. Matsumoto, & J. L. Zhang. (2015). The effect of manager-specific optimism on the tone of earnings conference calls. *Review of Accounting Studies* 20 (2): 639–673.
- [14] Chen, G., Crossland, C., & Luo, S. (2015). making the same mistake all over again: Ceo overconfidence and corporate resistance to corrective feedback. *Strategic Management Journal*, 36(10), 1513-1535.
- [15] Libby, R., & Rennekamp, K. (2012). Self-serving attribution bias, overconfidence, and the issuance of management forecasts. *Journal of Accounting Research*, 50(1), 197-231.
- [16] Davis, A. K., W. Ge, D. Matsumoto, and J. L. Zhang. (2015). The effect of manager-specific optimism on the tone of earnings conference calls. *Review of Accounting Studies* 20 (2): 639–673.
- [17] Huang, J., Mei, Z., & Li, Z. (2020). Business and financial information integration and voluntary management earnings forecasts. *China Journal of Accounting Research*, 13(3), 291-307.
- [18] Kerr, W. R. (2008). Ethnic scientific communities and international technology diffusion. *Review of Economics and Statistics* 90 (3): 518–537.
- [19] Tadros, H., Magnan, M. (2019). How does environmental performance map into environmental disclosure? A look at underlying economic incentives and legitimacy aims. *Sustain. Account., Manage. Policy J.* 10 (1), 62–96.