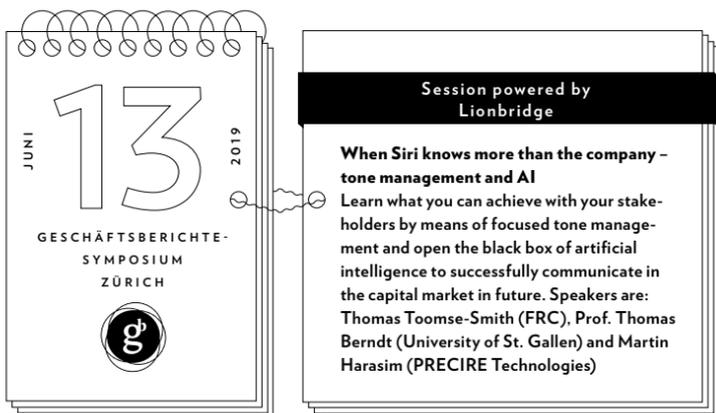


HOW M&A BEHAVIOR INFLUENCES THE

THE TONE OF THE TOP

Beyond the world of financial data, both accounting research and investor practice increasingly discover the field of nonfinancial information. Greater-than-ever data availability paired with the continuous rise in computing capabilities allow for enhanced qualitative analyses. In a recent study, we use sentiment analysis and dedicate ourselves to the strategic management of the tone of different disclosure media. We find that top managers systematically hype their firms prior to M&A-rich periods.

By Christopher M. Neumann, Felix A. Hermes and Thomas Berndt



The rise of qualitative analysis in the accounting domain

The manipulation of the perception of investors and other stakeholders by means of financial and communication strategies has been research object for a long time. In the past, investors and analysts have focused on accounting numbers and accounting techniques (earnings management) that produce financial reports presenting an overly positive view of a company's business activities and financial position. Yet, the rise in data availability and computing capabilities, nowadays, allow for enhanced qualitative analyses of communication strategies (esp. tone management) as well. Over the last ten years, sentiment analysis – as one part of qualitative analysis – has gained momentum and affected the field significantly.

ABOUT THE STUDY

The study analyzed the tone of more than 1,000 disclosure texts from EuroStoxx50 companies. We examine financial communications management in the context of M&A transactions. Key results are made available in the paper "Do European companies use financial communications management prior to M&A deals? – A sentiment analysis of press releases and quarterly reports" written by the same three authors.



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Qualitative analyses in accounting and finance typically fall into either one of the following categories: (i) sentiment analysis, (ii) targeted phrases, (iii) topic modeling, (iv) measures of document similarity and (v) readability. Research on objectifying textual sentiment – the degree of positivity or negativity in text – has progressed most considerably in this regard. Financial reporting-specific word lists have evolved gaining high recognition and utilization for sentiment analyses.

A substantial body of the accounting literature focuses on quantifying the effects of revealed textual sentiment by corporations on future earnings and stock price reactions. Researchers found that a higher level of pessimistic language in management discussion and analysis correlates with lower future earnings. The same holds true for stock price reactions: sentiment expressed in corporate disclosures lead to similar stock price reactions after publication. Interestingly, negative sentiment influences downward stock returns more significantly and in a more timely manner than positive sentiment causes positive returns.

With the knowledge that the tone of corporate disclosures affects the corporate's stock price a new question arises that can be addressed by accounting researchers: do corporations use tone management strategies opportunistically and mislead investors in incentive-rich situations?

"Tone of the top" around M&A

In a recent study, the IFF-HSG has taken up the growing research vein. Using the sentiment analysis technique, we examine discretionary management of disclosure tone for EuroStoxx50 companies. We analyze more than 1,000 earnings press releases and

Top managers opportunistically hype their firms prior to M&A.

quarterly reports to find out whether corporate leaders follow private incentives (as captured by M&A activity) to self-servingly manage disclosure tone.

We use abnormal tone to measure the sentiment spread in different disclosures. This variable captures the level of positivity or negativity that cannot be explained by firm fundamentals. To determine the texts' sentiment, we make use of a word list approach that helps us to classify terms as either positive or negative.

We find that tone management is used differently depending on the disclosure medium: while we do not detect significant abnormal tone in quarterly reports, there is ample evidence for tone management in press releases (statistical significance on the 5%- and 10%-level for a set of four different measures for M&A activity). These results likely arise from the differing degrees of freedom that the different communication channels provide executives to arbitrarily manage disclosure tone. Regulated disclosure media do not provide much room for top managers to spread optimism to their advantage – neither using financial nor non-financial information. The absence of tone management can be interpreted as support for the effectiveness of checks and balances in well-regulated disclosure media (e.g., internal and external auditing procedures, accounting principles, conduct of M&A due diligence, deterrent impact of potential litigations). In contrast, media with less limitations (here: earnings press releases) provide a particularly fruitful soil for managers to exceedingly hype their firms. Accordingly, managers opportunistically (mis)-use the possible discretion due to a lack of control mechanisms in their interest. We therefore recommend the readers to carefully consume unaudited disclosure media.