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Quarterly Reports: Nuisance or Benefit?

FINANCE: Some Say The Process Limits Company Focus

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San Diego — Quarterly earnings results grab the attention of nearly everyone in the financial world — investors, analysts, competitors, even reporters. They're a brief glimpse into the inner workings of major corporations, with earnings per share even a few cents higher or lower than expected leading to serious stock spikes.

But required quarterly earnings may soon become an artifact. The Securities and Exchange Commission recently asked whether the economy would be better off with less frequent reports, perhaps only two per year. It's the agency's response to a years-long debate over short-termism, a corporate mindset some say causes executives to focus on beating quarterly expectations at the expense of long-term gains.

Sean Clayton

The SEC's request comes as just a small part of a nearly 300-page "concept release," with hundreds of questions about how it could potentially modernize financial disclosure requirements. Parties have about three months to weigh in, though there's no guarantee the SEC will take any action.

Most investors are likely to oppose any cuts to required disclosures, one of their most useful tools for predicting a company's performance. Large companies, meanwhile, would prefer having to spend less time and money on exacting financial disclosures.

"There's going to be zero surprise as to how the comment letters come down," said Cooley LLP partner Sean Clayton, who represents public companies. "Almost every company will strongly advocate for less frequent reporting and investors will advocate for more frequent reporting."

An exception, Clayton said, could be longer-term institutional investors who throw in with companies.

A Child of the '70s

The SEC first required public companies to post annual reports in 1934 and expanded to semi-annual filings in 1955. The agency added quarterly requirements in 1970, in part because the New York Stock Exchange and other exchanges already required quarterly disclosures in order to be listed. About 70 percent of public companies at the time already filed the reports, but the SEC said the standards were minimal and some filings were near worthless.

But in the decades since, some academics and business groups have argued the consequence of issuing in-depth reports every 90 days pushes management to focus on earnings targets rather than long-term strategies. Activist investors also waged just under 100 proxy fights for board seats last year, so executives may have good cause to be concerned about sacrificing short-term value.

Last summer, Wachtell Lipton Rosen & Katz founding partner Martin Lipton wrote a short memo drawing attention to European asset manager Legal & General Investment Management's lobbying effort to the 350 largest companies on the London Stock Exchange. The European Union in 2013 stopped requiring quarterly reports, and Legal & General wanted to underline that focusing on short-term performance isn't necessarily conducive to building a sustainable business."The SEC should keep these observations in mind in pursuing disclosure reform initiatives and otherwise acting to promote, rather than undermine, the ability of companies to pursue long-term strategies," Lipton wrote.

Audit firm Ernst & Young LLP wrote directly to the SEC in November, arguing that semiannual reporting may be best for smaller companies not listed on national exchanges as a way to cut compliance costs.

San Diego's largest public companies either declined to comment or didn't respond to emails. A Qualcomm Inc. spokesperson declined to comment, but said her response had been delayed due to the company's recent earnings release.

Too Much Information?

Even advocates of less frequent disclosures are skeptical the SEC will completely abandon quarterly requirements, at best hoping for exceptions for smaller companies. Most investors would still care about quarterly results and removing the requirement could force analysts to figure out performance themselves. While stock prices may not react as frequently to earnings results, semi-annual releases may cause more pronounced spikes as investor angst stays pent up for longer periods of time, according to San Diego State University accounting professor David DeBoskey.

David DeBoskey

"Stock markets thrive on information and earnings are the blood that feed markets," DeBoskey said. "Blunting that feeding source will result in more rather than less volatility."

Less frequent disclosures could also make it harder for companies to attract investments. Equity costs can be lower with regular information because investors may be willing to take on larger risks only with more data.

Robbins Geller Rudman & Dowd LLP specializes in litigation on behalf of investors seeking to stop alleged executive misconduct, and partner Darren Robbins said investors can grow concerned when executives have much more information than shareholders.

Darren Robbins

"It seems counter-intuitive they would relax the very mechanism that ensures the quality of our markets, which is sunlight," Robbins said. "You want to put the people who own the asset on equal footing with management. It's balanced by quarterly reporting."

Robbins added that critics concerned about short-term thinking should work to reform individual companies' incentive structures to reward longer-term strategies. While activist battles are a regular occurrence, he argued they should not drive regulatory policy.

"So you disappoint Wall Street for two quarters," Robbins said. "As long as you're disclosing, you just shift (your) shareholder base to longer-term investors. They're really saying in code that lots of compensation is short-term focused. It's a corporate governance issue.”

Measurements Not Uniform

The SEC noted that various industries may prefer different rules on regulatory disclosures. Investors in smaller, capital-intensive technology companies, such as biotech firms, may focus more on major technology developments or clinical trial results than quarterly earnings, the SEC said.

“Life sciences companies are the prototypical example of where quarterly reporting is busted,” said Clayton, the Cooley partner.


David Diamond

It makes far more sense for revenue-dependent companies to issue earnings four times a year than it does for a life science company still in its research and development phase, he said. Quarterly earnings for those companies, according to Cooley, mean basically nothing compared with late-stage clinical trial results or regulatory decisions.

David Diamond, a managing director at accounting firm CBIZ Inc., works extensively with life sciences companies and has helped take several public, including Organovo Holdings Inc. and Sorrento Therapeutics Inc. He agreed that clinical trial results loomed large, but said there was a vital caveat. Investors are interested in a company’s burn rate, or how quickly it is spending its past investments and how long it could last before needing another round. Quarterly disclosures help investors stay updated, so research-focused companies could still have a use for the reports, despite their expense.

“All of these guys need more and more money for drug discovery,” Diamond said.