The Joint Effect of Equity-Based Compensation to CEO and Outside Directors on Management Earnings Forecasts: Complement or Substitute?

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Abstract

This study examines how chief executive officer (CEO) and outside director equity-based compensation jointly affects management earnings forecast (MF) disclosure. Our results reveal that either CEO or director equity-based compensation increases the likelihood and frequency of MF disclosure and enhances the accuracy of MFs in general. However, an increase in director (CEO) equity-based compensation is not effective when CEO (director) equity-based compensation is already high. These results suggest that when one mechanism does not acts as a complement but a substitute for the other in enhancing the properties of MFs. Overall, our evidence suggests that equity-based compensation of CEOs and that of outside directors affect firms’ voluntary information disclosure but the two effects are interdependent.

Key Words: Equity-based compensation; Management earnings forecasts; Information asymmetry; Agency costs