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A PRACTICE WORTH ENDING: EPS GUIDANCE HARMING LONG-TERM GROWTH

*Rachel G. Miller**

Introduction

Public companies are often praised for their efforts to facilitate transparency among investors.[1] Federal securities laws were constructed around a single concept: the more information provided by companies, the better protected their investors would be.[2] However, in the summer of 2018, President Donald J. Trump challenged this longstanding approach and urged the Securities and Exchange Commission (SEC) to investigate the potential for changing the financial reporting requirement for publicly held corporations from quarterly reporting to semiannual.[3] The request comes off the coattails of many prominent business leaders, including Warren Buffett, Jamie Dimon, and Indra Nooyi, encouraging public companies to move away from current practices resulting in an unhealthy focus on short-termism and to instead focus on long-term strategy and sustainability.[4]

Following the stock market crash of 1929, investors not only lost their investments, but also their confidence in the market.[5] The Securities

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1 *See* Yuting Lin & Andreas B. Eisingerich, *Can You Handle the Truth? How Transparent Companies Become Role Models to Consumers*, FORBES (Aug. 20, 2018), https://www.forbes.com/sites/imperialinsights/2018/08/20/can-you-handle-the-truth-how-transparent-companies-become-role-models-to-consumers/#1d45d35928ed.

2 Peter J. Henning, *Companies Are Pushing for Less Disclosure. Is That Good for Investors?*, N.Y. TIMES (Sept. 14, 2018), https://www.nytimes.com/2018/09/14/business/dealbook/sec-disclosure-investors.html.

3 *Id.*; *see also* Dave Michaels et al., *Trump Asks SEC to Study Six-Month Reporting for Public Companies*, WALL ST. J. (Aug. 17, 2018), https://www.wsj.com/articles/trump-directs-sec-to-study-six-month-reporting-for-public-companies-1534507058.

4 Michaels et al., *supra* note 3; *see also* Jamie Dimon & Warren E. Buffett, *Short-Termism Is Harming the Economy*, WALL ST. J. (June 7, 2018), https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801.

5 Debbie Hadley, *7 New Deal Programs Still in Effect Today*, THOUGHT CO. (July 24, 2019), https://www.thoughtco.com/new-deal-programs-still-in-effect-today-4154043.

Exchange Act of 1934,[6] along with other measures taken by Congress, "was designed to restore investor confidence in our capital markets by providing investors and the markets with more reliable information and clear rules of honest dealing."[7] Almost forty years later, in 1970, federal securities laws began requiring public companies to issue quarterly reports.[8] The purpose of creating Form 10-Q, the form companies use to file quarterly reports, was primarily to provide investors with summarized financial information within forty-five days after the end of each of the first three fiscal quarters.[9] Such information would ensure investors received adequate financial information to make informed decisions regarding their investments.

During the late 1990s, many companies began a new practice of issuing earnings guidance.[10] Earnings guidance is broadly defined as comments and financial projections management makes regarding its company's future earnings.[11] Companies that issue earnings guidance usually provide the guidance in the form of quarterly or annual earnings per share (EPS) guidance.[12] This guidance can be provided as an exact estimate or a range of what the company is forecasting its EPS to be for the upcoming quarter.[13] This shift toward companies providing additional forward-looking guidance on what management expects next quarter's earnings to be became an instrumental approach resulting from the Private Securities Litigation Reform Act of 1995 (PSLA).[14] The PSLA included many protections to shield companies from liability for statements regarding their projected performance.[15]

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6 Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78qq).

7 *What We Do*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/Article/whatwedo.html (last updated June 10, 2013).

8 Adoption of Form 10-Q, Securities Exchange Act Release No. 34-9004 (Oct. 28, 1970).

9 Quarterly Reporting Form, 35 Fed. Reg. 17,537 (Nov. 14, 1970) (codified at 17 C.F.R. pt. 249.308a).

10 Peggy Hsieh et al., *The Misguided Practice of Earnings Guidance*, MCKINSEY ON FIN., Spring 2006, at 1, 1, https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-misguided-practice-of-earnings-guidance. In this Note I interchangeably refer to earnings guidance, earnings forecasts, earnings estimates, EPS guidance, and earnings projections to synonymously mean predictions of future earnings.

11 Rick Wayman, *Earnings Guidance: Can It Predict the Future?*, INVESTOPEDIA, https://www.investopedia.com/articles/analyst/03/012903.asp (last updated Dec. 18, 2017).

12 EPS is calculated by dividing the company's total earnings by the number of outstanding shares. James Chen, *Earnings Per Share—EPS Definition*, INVESTOPEDIA, https://www.investopedia.com/terms/e/eps.asp (last updated July 14, 2019).

13 For example, a company could state estimated earnings per share to be $3.25 or could estimate that EPS would be between $3.00 and $3.75. In general, it is more common for companies to provide an EPS range.

14 Private Securities Litigation Reform Act of 1995, Pub. L. No. 104–67, 109 Stat. 737; *see also* Hsieh et al., *supra* note 10, at 1.

15 Hsieh et al., *supra* note 10, at 1.

In addition to management providing its own EPS guidance, analysts working outside the company also calculate and project next quarter's earnings forecasts.[16] Both management's and analysts' calculations of EPS guidance provide investors with hard-and-fast projections used to evaluate the company. It has become a common perception that if a company meets or exceeds its EPS guidance, the company is in good financial health, and if the company misses its guidance, the company must be struggling. Regardless of whether a company misses its own EPS guidance or misses the consensus estimate provided by analysts, a company will likely face a sharp decline in its stock price. Therefore, management is greatly incentivized to prevent missing the guidance. Indeed, a number of studies have shown that it is common for companies to defer long-term investments to meet short-term earnings targets.[17] One of the earliest studies found that eighty percent of CFOs would reduce discretionary spending on value-creating activities, such as marketing and research and development, in order to meet the company's short-term earnings targets.[18]

The desire to meet EPS guidance forces management to think solely in terms of short-term financials and has led many companies to avoid or minimize thinking about long-term strategy. This focus on short-termism is harming investors—likely without many knowing it—as they are made to believe that if a company meets its short-term earnings, it is in their best interest. Short-termism refers to the practice of corporate decisionmaking based on short-term earnings expectations rather than focusing on long-term value creation.[19] When management provides quarterly EPS guidance, the company overemphasizes the need to meet short-term financial goals and minimizes the need for long-term growth, resulting in diminished returns for the company's long-term investors.[20] The current practice of issuing quarterly earnings guidance has caused management to focus solely on short-term incentives rather than to pursue long-term growth investments. Moreover, it

16 *See* Ben McClure, *Earnings Forecasts: A Primer*, INVESTOPEDIA, https://www.investopedia.com/articles/stocks/06/earningsforecasts.asp (last updated Jan. 24, 2018); *see also Analyzing Analyst Recommendations*, U.S. SEC. & EXCH. COMM'N (Aug. 30, 2010), https://www.sec.gov/tm/reportspubs/investor-publications/investorpubs analystshtm.html.

17 *E.g.*, REBECCA DARR & TIM KOLLER, MCKINSEY & CO., HOW TO BUILD AN ALLIANCE AGAINST CORPORATE SHORT-TERMISM 4 (2017), https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/How%20to%20build%20an%20alliance%20against%20corporate%20short%20termism/How-to-build-an-alliance-against-corporate-short-termism.ashx; John R. Graham et al., *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & ECON. 3 (2005).

18 Graham et al., *supra* note 17, at 32–35.

19 DEAN KREHMEYER ET AL., BREAKING THE SHORT-TERM CYCLE 1 (2006), https://www.cfainstitute.org/-/media/documents/article/position-paper/breaking-the-short-term-cycle.ashx.

20 This Note is primarily based on research demonstrating the proposition that *quarterly* EPS guidance leads to short-termism; however, throughout I expand my thesis to include all (quarterly and annual) EPS guidance issued by a company.

is not the frequency of reporting that is causing short-termism, but rather management's behavior resulting from the company's issuance of EPS guidance. This Note argues that there should *not* be a reduction in reporting requirements, as the frequency and content of Form 10-Q disclosures are not the source of short-termism. However, short-termism *does* result from the voluntary practice of companies issuing earnings guidance to investors—which wrongly incentivizes myopic management decisions—and such practice should be halted to encourage long-term growth and investment. Investors need timely and accurate information in order to make informed investment decisions, but they do not need forward-looking quarterly EPS guidance to make those decisions.

On December 18, 2018, the SEC requested comments on how to maintain or enhance investor protections provided by the current periodic reporting system while reducing potential burdens on reporting companies.[21] The request also sought comments relating to potential changes to the frequency of periodic reporting, as well as on whether the current system of periodic reports and earnings guidance foster an excessive emphasis on short-term considerations.[22] The comment period ended March 21, 2019, and the SEC must now determine how to proceed and what action may be appropriate regarding quarterly reports and EPS guidance.[23]

This Note focuses on one factor—EPS guidance—that contributes to myopic behavior and short-termism within public companies. Part I discusses the history of the shareholder primacy norm and the need for management to act in the best interest of its shareholders. Additionally, this Part provides background on EPS guidance and the notion of short-termism. Part II lays out a framework for quarterly reporting and argues that the current disclosure requirements should remain intact. This Part addresses the importance of frequency in quarterly reporting and provides two examples—the United Kingdom and Regulation A—of practices with longer reporting frequencies that demonstrate longer interim periods on their own do not deter short-termism. Further, Part II discusses the content of the required disclosures, including the disclosure of forward-looking information, as well as possible implications, including a reduction in transparency and potential for insider trading, that may occur if the SEC decreases the reporting requirements. Part III examines quarterly forward-looking earnings guidance and argues that when management provides EPS guidance, it incentivizes short-term behavior that is suboptimal for investors. Part III additionally discusses in detail earnings reports and EPS guidance, including a discussion on analysts' role in calculating EPS and the ability for continued calculation. This Part is designed to demonstrate that it is how management reacts to EPS guidance that leads to short-termism. Further, this Part provides two examples of companies that provide annual EPS guidance and quarterly EPS guidance illus-

21 Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. 65,601, 65,601 (Dec. 21, 2018) (to be codified at 17 CFR pt. 210).

22 *Id.*

23 *Id.*

trating how, regardless of frequency, management still behaves myopically. Part IV explores specific ways management manipulates and deters long-term growth to ensure the company meets or exceeds their EPS guidance. This Part seeks to demonstrate that management's myopic behavior occurs as a result of issuing EPS guidance. Part V argues that by preventing companies from issuing EPS guidance the company will be better equipped to focus on long-term growth initiatives, which are in the shareholders' best interests. This Note concludes by suggesting companies will better align their interests with investors and provide management with the flexibility needed to pursue long-term goals by replacing EPS guidance with long-term roadmaps, overall reducing short-termism.

I. Background

Officers within a publicly held corporation are faced with many daily challenges that occupy both their time and energy. It is a rare occasion when management is forced to rethink whether they are truly acting in the best interests of its shareholders—the owners of the corporation. This Part seeks to provide context to this Note by discussing the obligation management of publicly held companies has to act in the best interests of the company's shareholders. Additionally, this Part will provide a brief overview of EPS guidance and the short-termism that results.

A. *Shareholder Primacy Norm*

Shareholder primacy has long dominated corporate governance literature as a fundamental norm that corporate managers should act to maximize shareholder wealth.[24] In 1919, the Supreme Court of Michigan decided *Dodge v. Ford Motor Company*—a case commonly cited in support of shareholder primacy[25]—where it upheld the shareholder primacy norm stating that "[a] business corporation is organized and carried on primarily for the profit of the stockholders."[26] The court established that "it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others."[27] Thus, the court clarified that managers must not only act in the best interests of the shareholders, but also must act primarily to maximize the profit of the shareholders.

In order to ensure corporate managers are fulfilling the shareholder primacy norm, the law provides legal principles to hold managers accountable for their actions. First, corporate managers, in their capacity as agents of the

24 *See* Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 Minn. L. Rev. 1951, 1951–52 (2018).

25 D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. Corp. L. 277, 278 (1998), https://digitalcommons.law.byu.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1027&context=faculty_scholarship.

26 Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

27 *Id.*

shareholders, have a duty to act in the best interests of the shareholders and, more specifically, to maximize shareholder value.[28] In a typical agency relationship, the principal has the power to control the agent's behavior.[29] However, in the corporate context, the shareholders' power to control the managers as day-to-day decisionmakers of the corporation is far more limited. Because of the more distant relationship, fiduciary duties often function to fill the gaps in order to ensure managers are acting in the best interest of the company's shareholders. In 2010, the Delaware Court of Chancery reaffirmed that corporate directors are bound by "fiduciary duties and standards," which include "acting to promote the value of the corporation for the benefit of its stockholders."[30]

Today, in order to fulfill the shareholder primacy norm, corporate managers must do more than simply maximize shareholder wealth. Historically, both shareholders and managers measured wealth based on whether the company met or exceeded its quarterly and annual earnings guidance. However, today, in order for companies to maximize shareholder value, they must facilitate long-term value creation.[31] Some scholars suggest that in order for officers and directors to fulfill their fiduciary duties by acting in the best interest of the company's shareholders, they must act to maximize shareholder interests in the "long run."[32]

Today's investors are not only concerned with their return on investment; they exceedingly expect more from the companies in which they invest. A recent cultural shift toward responsible investing is causing companies to rethink decades-old practices. "Responsible investing is widely understood as the integration of environmental, social and governance (ESG) factors into investment processes and decision-making."[33] Broader than the Socially Responsible Investment (SRI) movement, which focuses primarily on moral and ethical criteria, investors believe that ESG factors are relevant for financial valuation.[34] ESG is becoming an important data point for investors to consider when determining in which companies they will invest. Investors are therefore looking for companies that are well positioned to succeed in the long term and leaving behind companies willing to make a profit in the

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28 Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999), *reprinted in* CORPORATE GOVERNANCE 50, 50–51 (Thomas W. Joo ed., 2d ed. 2010).

29 RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. LAW INST. 2006).

30 eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010).

31 *See* Martin Lipton, *It's Time to Adopt the New Paradigm*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 11, 2019), https://corpgov.law.harvard.edu/2019/02/11/its-time-to-adopt-the-new-paradigm/ (explaining that companies have "embraced" the "new mindset" that they must "achieve sustainable long-term investment and growth").

32 Blair & Stout, *supra* note 28, at 61.

33 Georg Kell, *The Remarkable Rise of ESG*, FORBES (Jul. 11, 2018), https://www.forbes.com/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/#180363a1695.

34 *See id.* (explaining that factoring ESG into "investment process and decision-making" is "responsible investing," even though the [SRI] movement has been around much longer").

short term at any cost. In response to investors' demands for assurances on a company's sustainability efforts, companies have implemented sustainability and corporate social responsibility programs in order to participate in voluntary reporting on ESG standards.[35] However, while a growing number of companies have ESG policies promoting long-term growth, a recent study revealed a failure to convey such information to investors.[36] This study indicated that CEOs and executives leading earnings calls failed to reveal relevant long-term strategies and instead focused on short-term financial results.[37] When the calls opened to question-and-answer, it was not the executives, but rather analysts initiating discussion on long-term growth and ESG data.[38]

As investors are becoming increasingly focused on soft factors, such as ESG, when making investment decisions, companies are greatly positioned to shift away from issuing EPS guidance. Such a shift will align with investors' interests in long-term sustainability while disincentivizing management's short-term financial prerogatives.

B. History of EPS Guidance

Earnings guidance is a voluntary disclosure that allows management to communicate to investors the company's projected earnings for the upcoming period.[39] The voluntary nature of the guidance provides management full discretion on when and how the company will communicate such projections to its investors.[40] The practice of issuing earnings guidance increased in prevalence in the mid to late 1990s, following Congress's release of the PSLA, which protected companies from liability for statements about the company's projected performance.[41] Companies primarily issue quarterly earnings guidance in the form of EPS forecasts. The purpose of providing EPS guidance is to communicate to investors management's expectations for the upcoming quarter.[42] Additionally, EPS guidance provides a check on management, as investors are able to hold managers accountable for missing expectations.

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35 *See* KRISTIAN HEUGH & MARC FOX, MORGAN STANLEY, ESG AND THE SUSTAINABILITY OF COMPETITIVE ADVANTAGE 3 (2017), https://www.morganstanley.com/im/publication/insights/investment-insights/ii_esgandthesustainabilityofcompetitiveadvantage_us.pdf ("In response to increasing questions regarding how sustainability impacts their business, many companies have implemented sustainability and corporate social responsibility programs, participate in voluntary initiatives and report on ESG standards.").

36 Sakis Kotsantonis et al., *If CEOs Care About the Long Term, Why Don't They Talk About It?*, HARV. BUS. REV. (Nov. 13, 2015), https://hbr.org/2015/11/if-ceos-care-about-the-long-term-why-dont-they-talk-about-it.

37 *Id.*

38 *Id.*

39 *See* Hsieh et al., *supra* note 10, at 1.

40 *See id.*

41 *Id.*

42 *See* Wayman, *supra* note 11.

While EPS guidance is a nonbinding projection of the company's future earnings, failing to meet or exceed the projected earnings may result in loss of investor confidence and a sharp decline in stock price. In order to prevent such a loss, management closely monitors earnings for the quarter and is incentivized to take action to prevent missing the projected EPS.

C. Short-Termism

Corporate governance literature has long identified and criticized management's myopic behavior and short-termism within public companies.[43] Short-termism is defined as an excessive focus on short-term results at the expense of long-term opportunities.[44] While there are many factors that contribute to short-termism, there remains a consensus that a main source of the problem is the pressure public companies face to maximize short-term results by meeting or exceeding their EPS guidance.[45]

The focus on short-term earnings likely results from companies' struggles to prioritize long-term growth and sustainability. Short-term earnings provide companies with a definitive projection that management is able to clearly meet, thereby demonstrating to investors the company's good financial health and value. However, measuring the success of long-term growth initiatives is exceedingly more difficult to quantify and convey to investors.

Short-termism is not the result of disclosure requirements—it is instead the result of management choices. As discussed in more detail in Part IV, management is incentivized to take action to prevent missing quarterly EPS guidance.[46] In order to avoid missing EPS targets, management often manipulates the company's financial statements to achieve optimal performance for the current quarter.[47] Such manipulation detracts from long-term investment and growth opportunities and likely results in diminished long-term earnings.

When management focuses on meeting short-term goals, rather than long-term growth strategies, investors often do not know management took action to achieve the targeted EPS, and further, do not know that the action taken detracted from the long-term opportunities of the company.

II. Quarterly Reports

The various reporting requirements public companies must comply with allow investors to benefit from timely disclosures of standard, reliable, and

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43 *See, e.g.*, Hsieh et al., *supra* note 10.

44 Krehmeyer et al., *supra* note 19, at 3.

45 *Long-Termism Versus Short-Termism: Time for the Pendulum to Shift?*, Institutional Inv. (June 13, 2016), https://www.institutionalinvestor.com/article/b14z9mxp09dnn5/long-termism-versus-short-termism-time-for-the-pendulum-to-shift.

46 *See infra* Part IV.

47 *See infra* Part IV.

relevant information.[48] Proper disclosure allows investors to evaluate a company for future investments and also monitor management for corporate governance purposes.[49] By contrast, a lack of disclosure creates information asymmetry between managers and investors, thereby reducing investor confidence and increasing the potential for insider trading.[50] This Part discusses the importance of frequency in reporting and provides two examples where longer reporting frequencies failed to deter short-termism. Additionally, this Part expands on the content of disclosures and possible implications that may result if the SEC decreases the reporting requirements.

A. *Frequency of Quarterly Reporting*

In addition to annual reports on Form 10-K, and current reports on Form 8-K, the Securities Exchange Act of 1934 requires public companies to file quarterly reports issued on Form 10-Q.[51] Federal securities laws have required quarterly reporting since 1970.[52] However, even prior to the quarterly requirement, seventy percent of public companies issued quarterly reports.[53] Quarterly reports are designed to increase transparency to investors by providing unaudited financial statements and continuing insights into the company's financial health throughout the year.[54]

The current system of quarterly reporting is an important dimension of transparency for investors. Quarterly reports play a vital role in leveling the playing field among investors with regard to their access to information.[55] With a relatively short period of time between quarterly reports, average investors are able to maintain confidence through continual access to meaningful information.[56] A move to less frequent reporting has the ability to create an information divide between sophisticated investors, who are able to access additional data, and average investors, who are not.[57] Therefore, any

48 Letter from James J. Angel, Assoc. Professor of Fin., Georgetown Univ., to U.S. Sec. & Exch. Comm'n (Mar. 22, 2019), https://www.sec.gov/comments/s7-26-18/s72618-5180415-183547.pdf.

49 *Id.*

50 Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,992 (Apr. 22, 2016) (to be codified at 17 C.F.R. § 210).

51 *See* Adoption of Form 10-Q, Exchange Act Release No. 34-9004 (Oct. 28, 1970).

52 *See id.*

53 Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. at 23,992.

54 *Fast Answers: Form 10-Q*, U.S. SEC. & EXCH. COMM'N (last updated Sept. 2, 2011), https://www.sec.gov/fast-answers/answersform10qhtm.html.

55 Letter from Barbara Novick, Vice Chairman, BlackRock, to Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n 3 (Mar. 21, 2019) [hereinafter BlackRock Letter], https://www.sec.gov/comments/s7-26-18/s72618-5165791-183444.pdf.

56 *See id.* ("[A] move to less frequent reporting could . . . lower the confidence of average investors that they have access to meaningful and timely information with which to make decisions.").

57 *See* Avi Salzman, *Your Personal Data Is Being Used by Investors. Here's the Potential—and the Risks.*, BARRON'S (Nov. 30, 2018), https://www.barrons.com/articles/how-big-investors-

postponement in issuing reports runs the risk of lowering the confidence of average investors.[58] The potential loss in transparency and investor confidence outweighs the potential benefits of moving to semiannual reporting.

1. United Kingdom Approach

Prior to 2007, public companies in the United Kingdom were required to issue annual and semiannual earnings reports and financial statements.[59] In 2007, the United Kingdom—in what is now being referred to as a reporting "experiment"—began requiring mandatory quarterly reporting for public companies.[60] However, in 2014, the United Kingdom developed a plan to eliminate quarterly reporting in an effort to overcome the alleged short-termism resulting from the quarterly reporting requirement.[61] It subsequently dropped the quarterly reporting requirement "to reduce pressures that induce short-term decision making by corporate executives."[62] However, the decision to remove the reporting requirement did not have the intended effect. Following the repeal of the quarterly reporting requirement, most companies continued to issue voluntary quarterly reports.[63] Additionally, in a 2017 study, the CFA Institute found that "the initiation of required quarterly reporting in 2007 had no material impact on the investment decisions of UK public companies."[64] Further, the study noted that "moving from quarterly to semiannual reporting is not an effective remedy for undue corporate emphasis on short-termism."[65] Therefore, while the United Kingdom believed that the elimination of quarterly reporting would deter short-termism, the results not only demonstrated that companies were continuing to voluntarily issue quarterly reports, but also that management's focus on short-termism was not resulting from the frequency of quarterly or semiannual reporting.

2. Regulation A

In a much different example, under Regulation A, the SEC "allows companies to offer and sell securities to the public, but with more limited disclo-

use-your-personal-data-to-play-the-stock-market-1543627499 (noting that the average institutional investment firm now spends about $900,000 annually on alternative data).

58 BlackRock Letter, *supra* note 55, at 3.

59 ROBERT POZEN ET AL., CFA INST. RESEARCH FOUND., IMPACT OF REPORTING FREQUENCY ON UK PUBLIC COMPANIES 3 (2017), https://www.cfainstitute.org/-/media/documents/article/rf-brief/rfbr-v3-n1-1-pdf.ashx.

60 *Id.* at 2, 4.

61 *Id.* at 11.

62 Suresh Nallareddy et al., Consequences of Mandatory Quarterly Reporting: The UK Experience 2 (Mar. 1, 2017) (unpublished manuscript), https://ssrn.com/abstract=2817120.

63 POZEN ET AL., *supra* note 59, at 12.

64 *Id.* at 2.

65 *Id.* at 16.

sure requirements than what is required for publicly reporting companies."[66] As an exemption to the registration requirements of the Securities Exchange Act of 1934, Regulation A permits issuers to conduct a public offering of securities of up to $50 million in any twelve-month period and only requires issuers to prepare semiannual and annual reports.[67] While a Regulation A offering is often referred to as a "mini-IPO,"[68] the disclosure requirements vary from those traditionally required for public companies. This is likely because historically Regulation A was only available for nonreporting companies.

In 2015, prior to its revision of Regulation A, the SEC conducted a comment period soliciting comments regarding the frequency of the reporting requirements.[69] Many commentators made the argument that Regulation A companies should be subject to the quarterly reporting requirements, as they are not overly burdensome and increase investor protection.[70] However, the SEC disagreed and stated that the semiannual reporting requirement "strikes an appropriate balance between the need to provide information to the market and the cost of compliance for smaller issuers."[71] Additionally, the SEC stated that the information provided on the Regulation A semiannual report mimics much of the content of Form 10-Q including financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A).[72] Further, the additional information required by Form 10-Q, including "disclosure[s] about quantitative and qualitative market risk, controls and procedures, updates to risk factors, or defaults on senior securities" are "not applicable to, or appropriately tailored for, the types of issuers likely to conduct Regulation A offerings."[73]

On December 19, 2018, the SEC announced that public companies would also be allowed to use Regulation A to raise capital.[74] It is worth noting that under the expanded Regulation A, public companies will fulfill their

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66 *Updated Investor Bulletin: Regulation A*, U.S. SEC. & EXCH. COMM'N (May 24, 2019), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_regulationa.html.

67 17 C.F.R. § 230.251 (2019). Tier 1 allows offering up to $20 million and is not subject to ongoing reporting requirements. *Id.* Tier 2 of Regulation A permits offerings up to $50 million, but a Tier 2 offering subjects the issuer to ongoing reporting requirements. *Id.*

68 *See* Merrill M. Kraines et al., *Regulation A+: For Smaller Companies (and ICOs) a Better Way to Go Public?*, PEPPER HAMILTON LLP (Feb. 12, 2018), https://www.pepperlaw.com/publications/regulation-a-for-smaller-companies-and-icos-a-better-way-to-go-public-2018-02-12/.

69 Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,844 (Apr. 20, 2015) (to be codified at 17 C.F.R. pt. 200).

70 *Id.*

71 *Id.* at 21,847.

72 *Id.*

73 *Id.*

74 *See* David P. Hooper, *SEC Adopts New Rules Expanding Use of Regulation A+*, BARNES & THORNBURG LLP (Dec. 31, 2018), https://www.btlaw.com/insights/alerts/2018/sec-adopts-new-rules-expanding-use-of-regulation-a-plus.

Regulation A reporting requirements by complying with its reporting obligations under section 13 or section 15(d), rather than the separate Regulation A disclosure scheme.[75] Therefore, public companies utilizing Regulation A will still be required to file quarterly reports even though other nonpublic Regulation A issuers will not. The SEC had the opportunity to extend Regulation A's disclosure scheme of semiannual disclosures to public company issuers but declined to do so. This decision reiterates the SEC's position that semiannual reports for nonreporting Regulation A issuers are for unique, specific circumstances and would be inappropriately tailored for the majority of public companies.

Moreover, while nonpublic issuers under Regulation A are only required to issue semiannual reports, these issuers are primarily startup companies with little to no capital. Due to the limited entrepreneurial nature of such companies, these issuers' primary focus, regardless of whether they are required to file quarterly or semiannually, is on meeting short-term goals. Because of the limited circumstances under which companies are able to only issue semiannual reports, it is clear that the SEC wanted to encourage small, nonreporting companies to raise limited amounts of capital without the added requirement of quarterly reports. Such benefits derived from semiannual reporting would not be applicable to public companies. Moreover, the limited nature of issuers eligible for the Regulation A semiannual disclosure scheme makes it an unlikely argument that such scheme deters short-termism.

B. Contents of Quarterly Reports

Form 10-Q has two primary sections. Part I of Form 10-Q requires companies to provide financial information, including financial statements and MD&A.[76] The financial statements presented, including the company's balance sheet and income statement, may be condensed and unaudited.[77] Additionally, companies must include the MD&A section that seeks "to provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management."[78] Part II of Form 10-Q requires companies to provide other information including "Legal Proceedings" and "Risk Factors."[79] A company is required to disclose

75 *See* JAY H. KNIGHT & WILLIAM N. LAY, BASS, BERRY & SIMS, FAQS ABOUT REGULATION A+ SECURITIES OFFERINGS 3 (2017) https://www.bassberrysecuritieslawexchange.com/wp-content/uploads/sites/201/2018/06/Regulation-A-FAQ.pdf.

76 ERNST & YOUNG LLP, 2018 SEC QUARTERLY REPORTS—FORM 10-Q, at 14 (2017), https://www.ey.com/publication/vwluassetsdld/secquarterlyfinancialreporting10q_06547-171us_21november2017/$file/secquarterlyfinancialreporting10q_06547-171us_21november2017.pdf?OpenElement.

77 *Id.*

78 DIV. OF CORP. FIN, U.S. SEC. & EXCH. COMM'N, FINANCIAL REPORTING MANUAL 295 (2008), https://www.sec.gov/files/cf-financial-reporting-manual.pdf.

79 U.S. SEC. & EXCH. COMM'N, FORM 10-Q, at 5–6 (2019), https://www.sec.gov/about/forms/form10-q.pdf.

in its quarterly reports any material changes in risk factors it previously disclosed in its Form 10-K.[80]

Additionally, the SEC encourages companies to include forward-looking information to increase transparency and provide investors with projections on potential future performance.[81] In order to incentivize companies to disclose this information, Congress and the SEC created a safe harbor to prevent companies from being held liable for securities fraud in the event the forward-looking information turns out to be incorrect.[82] A company can rely on the safe harbor in its Form 10-Q by defining a forward-looking statement and providing cautionary language identifying important factors that could cause the actual results to be materially different. In 1987, the SEC distinguished between optional forward-looking disclosure and required forward-looking disclosure.[83] Forward-looking disclosure is required when the disclosure is based on "currently known trends, events and uncertainties that are reasonably expected to have material effects."[84] On the other hand, forward-looking disclosure is optional when the disclosure "involves either anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty."[85] However, it is critical to distinguish quarterly earnings guidance from forward-looking information within Form 10-Q. While companies *may* provide forward-looking information in Form 10-Q, such information is generally related to risk factors, rather than financial projections. Regarding financial information, Form 10-Q generally provides quarterly backward-looking reporting on factual financial performance from the past three months, whereas quarterly earnings guidance provides earnings projections for future quarters.

C. Potential Issues with Reducing Reporting Requirements

The SEC's Request for Comment raises the question of whether a reduction in reporting requirements—eliminating Form 10-Q—would minimize short-termism.[86] Investor comments suggest that the negative consequences likely to result from lengthening the time between required disclosures far

80 ERNST & YOUNG LLP, *supra* note 76, at 76–77.

81 SANDRA J. PETERS, CFA INST., FORWARD-LOOKING INFORMATION: A NECESSARY CONSIDERATION IN THE SEC'S REVIEW ON DISCLOSURE EFFECTIVENESS 10–11 (2014), https://www.cfainstitute.org/-/media/documents/article/position-paper/forward-looking-information-a-necessary-consideration-in-sec-review.ashx.

82 *Id.* at 11.

83 Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,943 (Apr. 22, 2016) (to be codified at 17 C.F.R. pt. 210).

84 *Id.*

85 *Id.* In *Basic, Inc. v. Levinson*, the Supreme Court framed the issue of materiality of forward-looking disclosure as depending upon a balancing of both "the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." Basic, Inc. v. Levinson, 485 U.S. 224, 231, 238 (1988) (quoting SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).

86 Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. 65,601, 65,608–09 (Dec. 21, 2018) (to be codified at 17 C.F.R. pt. 210).

exceed any benefits resulting from the reduction in reporting.[87] Investors rely on Form 10-Q to gain access to information—beyond historical financial performance—that promotes confidence and trust in their investments. Therefore, a reduction in reporting frequency would diminish transparency, resulting in diminished confidence in the company and a possible increase in insider trading.

1. Reduction in Transparency

Corporate transparency is paramount in maintaining investor confidence.[88] A strong correlation exists between the amount of information provided and level of investor confidence.[89] The more information provided, the more confident the investor; the less information provided, the less confident the investor. Additionally, stock prices tend to fluctuate more when information is unknown.[90] It is argued that in more transparent markets, due to the greater the amount of information available to investors, it is less likely that future unanticipated events will cause fluctuations in stock prices.[91] However, decreasing the frequency of reports would result in keeping investors in the dark for a longer period of time, thereby increasing the probability of greater stock fluctuations when investors subsequently learn of potential problems.

Following the scandals of the early 2000s, including the Enron scandal, investors have become hypersensitive to the reliability of company reports, where a slight hint of wrongdoing has the potential to diminish investor confidence and send share prices plummeting.[92] Investors now rely on quarterly reports for more than just viewing the company's past quarter's financial performance. Investors utilize the information provided in Form 10-Q as a way to assess and predict the company's health and ensure stable performance.[93]

87 *See generally Comments on Earnings Releases and Quarterly Reports*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/comments/s7-26-18/s72618.htm (last updated Oct. 4, 2019).

88 *See* Theodore Rosen et al., Should U.S. Companies Adopt Semi-Annual Reporting? An Analysis of Quarterly Reporting Requirements and the Practice of Earnings Guidance 10 (Dec. 17, 2018) (unpublished B.A. thesis, Brown University), https://entrepreneurship.brown.edu/wp-content/uploads/2019/01/Reporting-Guidance_Final-Paper-1-1.pdf.

89 Ben McClure, *Financial Reporting: The Importance of Corporate Transparency*, INVESTOPEDIA, https://www.investopedia.com/articles/fundamental/03/121703.asp (last updated June 25, 2019).

90 *How Corporate Transparency Influences Stock Returns*, CKGSB KNOWLEDGE (Dec. 16, 2011), http://knowledge.ckgsb.edu.cn/2011/12/16/finance-and-investment/how-corporate-transparency-influences-stock-returns/.

91 *Id.*

92 CHARTERED INST. OF MGMT. ACCT., BUSINESS TRANSPARENCY IN A POST-ENRON WORLD 1 (2002), http://www.cimaglobal.com/Documents/ImportedDocuments/BustransparencypostEnron_techrpt_0802.pdf.

93 *See id.* at 2–5 ("If a company's earnings management tactics are uncovered and publicised, investor confidence will disappear overnight and the share price can go into freefall.").

Reducing the frequency of disclosure requirements would therefore lead to diminished investor confidence and the likelihood of destabilizing our capital markets.

2. Insider Trading

Eliminating quarterly reports increases the amount of time corporate insiders have to sit on material nonpublic information. Therefore, an increase in the period of time between reports may result in an increase of insider trading. Commentators argue that as companies begin to release less information, the opportunities for insider trading will increase.[94] Daniel Taylor, a Wharton accounting professor, makes this connection by arguing that "more transparent and timely information reduces the benefits of private information, and reduces insider trading, specifically."[95] Less frequent reporting would therefore have the effect of allowing material nonpublic information to accumulate in hands beyond those of high-level employees.[96] In 2016, the National Investor Relations Institute (NIRI) eloquently stated, "[q]uarterly reporting allows for the timely 'purging' of material, non-public information that serves the purpose of equalizing the information available to investors."[97]

Additionally, quarterly reporting assists companies in complying with Regulation FD, which prevents companies from making selective disclosures of material nonpublic information.[98] While the threat of prosecution by the SEC for violating Regulation FD would still be an effective deterrent, companies will likely face enormous compliance challenges. Further, this may unduly hamper insiders' ability to lawfully engage in secondary resales, as insiders would face further restrictions on when they are permitted to conduct trades.

III. Forward-Looking Earnings Guidance

In addition to filing the required quarterly reports on Form 10-Q, many companies voluntarily provide earnings reports that often contain EPS guidance to investors. The practice of providing EPS guidance contributes to short-termism, as management faces great pressure, both internally and externally, to meet the projections. This Part seeks to clarify how the voluntary issuance of EPS guidance leads to management's myopic behavior and subsequently results in short-termism.

94 Rosen et al., *supra* note 88, at 9–10.

95 *Should Companies Abandon Quarterly Earnings Reports?*, Wharton Sch. U. Pa. (Aug. 27, 2018), http://knowledge.wharton.upenn.edu/article/ending-quarterly-reporting/.

96 Letter from Matthew D. Brusch & Michael C. McGough, Interim Co-CEOs, Nat'l Inv'r Relations Inst., to Brent J. Fields, U.S. Sec'y, Sec. & Exch. Comm'n 8–9 (Aug. 4, 2016), https://www.sec.gov/comments/s7-06-16/s70616-350.pdf.

97 *Id.* at 9.

98 *Fast Answers: Fair Disclosure, Regulation FD*, U.S. Sec. & Exch. Comm'n, https://www.sec.gov/fast-answers/answers-regfdhtm.html (last updated Oct. 27, 2014).

A. *Earnings Reports*

Most public companies that are required to file Form 10-Q also voluntarily communicate quarterly financial results to investors through the use of an earnings report.[99] In the SEC's Request for Comment, the Commission makes clear that "[f]ederal securities laws do not require reporting companies to publish earnings releases, conduct earnings calls with investors and analysts, or issue forward-looking earnings guidance."[100] Quarterly earnings reports generally take the form of a press release or earnings call and are intended to keep the company's investors up to date on the company's performance. If a company voluntarily elects to make a public announcement or release regarding its earnings, such an earnings report must be furnished, rather than filed, on Form 8-K.[101] To clearly differentiate between forms of liability, section 18 of the Exchange Act "imposes liability for material misstatements or omissions contained in reports and other information *filed* with the SEC. By contrast, reports and other information that are '*furnished*' to the SEC . . . do not attract liability under Section 18."[102] However, quarterly earnings reports remain subject to Exchange Act Rule 10b-5—therefore, the potential for liability in some form still exists.[103]

Earnings reports often mimic much of the same financial information a company will provide in its Form 10-Q. Therefore, given the potential overlap, a company often issues its earnings report simultaneously with the company's Form 10-Q filing.[104] Typically, however, a Form 10-Q will provide greater financial detail due to the requirements provided by Generally Accepted Accounting Principles (GAAP).[105] Further, while the financial statements provided in Form 10-Q may be unaudited, Regulation S-X requires that the financial statements must be reviewed by an independent

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99 Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. 65,601, 65,603 (Dec. 21, 2018) (to be codified at 17 C.F.R. pt. 210). Note that I prefer the use of the term earnings report to earnings release, however, for the purpose of this paper, the two terms reflect the same information. An earnings report or release is the broader document that may include EPS guidance.

100 *Id.*

101 *See* ZE'-EV EIGER & ANNA PINEDO, MORRISON & FOERSTER LLP, FREQUENTLY ASKED QUESTIONS ABOUT FORM 8-K, at 1 (2017), https://media2.mofo.com/documents/faq-form-8-k.pdf; *see also* Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. at 65,603.

102 EIGER & PINEDO, *supra* note 101, at 8 (emphasis added).

103 ERNST & YOUNG LLC, *supra* note 76, at 53.

104 *See* Salman Arif et al., A Growing Disparity in Earnings Disclosure Mechanisms: The Rise of Concurrently Released Earnings Announcements and 10-Ks 13 (June 6, 2018) (unpublished manuscript), https://ssrn.com/abstract=2801701 ("[T]he fraction of concurrent [earnings releases and Form 10-Q filings] has increased from 20% in 2002 to more than 60% by 2015."); *see also* Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. at 65,603.

105 Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. at 65,603.

auditor.[106] Additionally, executives and financial officers of the reporting company are subject to liability provisions regarding the financials.[107]

Unlike the financial information that is provided to investors in Form 10-Q, information provided in forward-looking earnings guidance is not subject to SEC review. Such information has been described as "unregulated management suggestion[s] of future trends that risk both misleading investors to focus on short-term rather than long-term business trends, and incentivizing management to actually delay or forego long-term investment that would have a positive effect on long-term earnings."[108] Additionally, information may be included in an earnings report that does not appear in the company's Form 10-Q.[109] Specifically, if a company is providing forward-looking EPS guidance, such information will only appear in the earnings report. Because of the additional safeguards on Form 10-Q disclosed information, a Form 10-Q must be viewed as separate and distinct from a quarterly earnings report.

B. EPS Guidance

Within the quarterly earnings report, companies may also disclose quarterly earnings guidance that provides investors with financial projections for the upcoming quarter. Specifically, the guidance is typically in the form of quarterly EPS guidance.[110] Also known as an earnings estimate, EPS guidance is management's estimate for the company's upcoming quarter's earnings per share. Earnings guidance provides forward-looking earnings forecasts issued by the company primarily to influence market expectations.[111] Start-up and relatively new companies commonly issue quarterly EPS guidance as a way for the company to easily demonstrate its success and

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106 ERNST & YOUNG LLC, *supra* note 76, at 8.

107 17 C.F.R. §§ 240.13a-14, 240.15d-14 (2018). Under these rules, certifying officers must

> certify, among other things, that they have reviewed the Form 10-Q and that based on their knowledge: (i) The 10-Q does not contain any untrue statement of material fact or omit to state a material fact necessary to make any statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the 10-Q; and (ii) the financial statements, and other financial information included in the 10-Q, fairly present in all material respects the financial condition, results of operations, and cash flows of the company as of, and for, the periods presented in the 10-Q.

Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. at 65,604 n.42 (citing 17 C.F.R. §§ 240.13a-14, 240.15d-14).

108 BlackRock Letter, *supra* note 55, at 5 (emphasis omitted).

109 Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. at 65,605.

110 EPS Guidance is additionally referred to as EPS forecasts, EPS projections, and earnings guidance.

111 *See* ARIEL FROMER BABCOCK & SARAH WILLIAMSON, THE CONFERENCE BD., QUARTERLY EARNINGS GUIDANCE—A CORPORATE RELIC? 2 (2018), http://www.shareholderforum.com/access/Library/20180300_ConferenceBoard-DirectorNotes.pdf.

build credibility among new investors.[112] However, both in the unregulated nature of the earnings report and the ability to readily provide forward-looking guidance, the reliability on EPS guidance raises concerns among market participants.[113]

Proponents of EPS guidance argue that quarterly EPS guidance facilitates communications among management and investors. Additionally, proponents argue that eliminating the company's guidance will not reduce management's pressure to meet quarterly earnings targets as analysts will still be issuing forecasts that will influence investor expectations.[114]

Opponents, however, argue that the practice of issuing quarterly EPS guidance is harmful as it creates undue pressure on managers to meet or exceed the company's forecasts.[115] Additionally, because the market correlates missed EPS guidance with a company doing poorly, management remains under intense pressure to meet the guidance to prevent investors from losing confidence in the company.[116] Further, opponents suggest that management sacrifices long-term initiatives in order to meet short-term financial goals.[117]

Although many market participants assume EPS guidance is common practice, issuance of forward-looking quarterly EPS guidance peaked in popularity in 2003, when 75% of U.S. firms issued quarterly forecasts.[118] Since then, as the harm caused by short-term guidance became better understood, the use of quarterly EPS guidance has declined.[119] "In 2016, just 17.8% of

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112 *See* James Heskett, *Should CEOs of Public Companies Offer Earnings Guidance?*, HARV. BUS. SCH. (Feb. 6, 2006), https://hbswk.hbs.edu/item/should-ceos-of-public-companies-offer-earnings-guidance (noting that generally EPS can demonstrate financial success to investors).

113 *See* Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. at 65,604–06.

114 Jong-Hag Choi et al., *Do Management EPS Forecasts Allow Returns to Reflect Future Earnings? Implications for the Continuation of Management's Quarterly Earnings Guidance*, 16 REV. ACCT. STUD. 143, 145 (2011).

115 *Id.*; *see also* Dimon & Buffett, *supra* note 4.

116 Choi et al., *supra* note 114, at 145.

117 *Id.*

118 ARIEL FROMER BABCOCK ET AL., FCLTGLOBAL, DRIVING THE CONVERSATION: LONG-TERM ROADMAPS FOR LONG-TERM SUCCESS 8 (2019), https://www.fcltglobal.org/docs/default-source/publications/driving-the-conversation—-long-term-roadmaps-for-long-term-success.pdf?sfvrsn=2bb218c_0; *see also* ARIEL FROMER BABCOCK & SARAH KEOHANE WILLIAMSON, FCLTGLOBAL, MOVING BEYOND QUARTERLY GUIDANCE 8 (2017) ("[I]ssuance of forward-looking quarterly EPS guidance peaked in popularity just after the turn of the millennium, approaching 50% of large cap companies in 2004." (citing Carol Anilowski et al., *Does Earnings Guidance Affect Market Returns? The Nature and Information Content of Aggregate Earnings Guidance*, 44 J. ACCT. & ECON. 36 (2007), https://www.fcltglobal.org/docs/default-source/publications/moving-past-quarterly-guidance—-a-relic-of-the-past.pdf?sfvrsn=77a9268c_2)); Anilowski et al., *supra* 45 ("[E]arnings guidance is now provided consistently by a set of relatively large firms that collectively account for about one-half of the market on a value-weighted basis . . . .").

119 BABCOCK ET AL., *supra* note 118, at 8.

companies in the S&P 500 and Euro Stoxx 300 with consistent guidance policies offered quarterly EPS guidance, and only 20.9% offered annual EPS guidance."[120] As investor surveys have overwhelmingly indicated the desire for access to long-term information, it is possible that the issuance of EPS guidance is following such trend.[121]

C. Analysts' EPS Forecasts

In addition to companies issuing earnings guidance projecting quarterly EPS forecasts, analysts, who are independent of the company, evaluate and issue EPS projections. Analysts serve an important role in promoting the efficiency of our markets by ferreting out facts and offering valuable insights on companies and industry trends. However, it is important for investors to know that these analysts may have conflicts of interest with the companies the analysts cover, and therefore their projections may be biased.[122] Such conflicts may include the fact that the analyst works for the underwriter or owns stock in the company.[123]

Regardless of whether companies issue quarterly EPS guidance, analysts will continue to speculate earnings for the next quarter.[124] It has been said that "[i]f companies don't set goals, Wall Street will."[125] However, it is well established that management, as insiders, can better predict future earnings than Wall Street analysts.[126] Therefore, if a company does not provide analysts with its predictions, it is likely that the analysts' estimates may become unreliable. The conflicts of interest that exist between the analysts and the company coupled with the removed nature of the analysts demonstrate the diminished reliability of such forecasts.

D. Continued Calculation

The calculation of EPS does not require management or experienced Wall Street analysts.[127] Average investors are able to calculate and roughly estimate a company's EPS simply by using a company's financial statements

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120 BABCOCK & WILLIAMSON, *supra* note 118, at 8.

121 *See id.*

122 *See Analyzing Analyst Recommendations*, U.S. SEC. & EXCH. COMM'N (Aug. 30, 2010), https://www.sec.gov/tm/reportspubs/investor-publications/investorpubsanalysts htm.html.

123 *Id.*

124 As discussed in Part IV, because short-termism is not resulting from the issuance of such EPS guidance, but rather management's actions to meet or exceed the company's guidance, the continuing projections by analysts will likely have no effect on management's myopic behavior.

125 Bob Pisani, *Ending Quarterly Earnings Guidance Won't Solve the Issue of 'Short-Term' Thinking*, CNBC (June 7, 2018), https://www.cnbc.com/2018/06/07/ending-quarterly-earnings-guidance-wont-solve-the-problem.html.

126 *See, e.g.*, Gene Epstein, *A Misguided Strategy*, WALL ST. J. (Feb. 19, 2007), https://www.wsj.com/articles/SB117167800605911935.

127 *EPS = total earnings / outstanding shares.*

contained in its quarterly and annual reports. However, the ability to compute EPS is not what is driving short-termism. Shareholders are not able to predict future EPS on their own. The calculation of EPS is based on backward-looking financial information by taking the portion of a company's net income that would be earnings per share if all the profits were paid out to its shareholders.

Short-termism results from management's projections of future EPS and the subsequent pressure to meet the guidance, not simply the calculation. Therefore, even though management will continue to be able to calculate its projected EPS prior to the end of a quarter, if the guidance is not published by the company, there will be less pressure to manipulate earnings to achieve the projected EPS. Moreover, while investors will subsequently be able to calculate EPS and determine changes that have been made, management—through the use of the long-term roadmap—will be able to broaden the evaluation criteria for investors.[128]

E. Companies Issuing EPS Guidance

When a company provides EPS guidance to its investors, there are two possible outcomes.[129] First, the company may perform well and exceed its estimated guidance, resulting in an increase in share price. Second, the company may underperform and miss its estimated guidance, resulting in a decrease in share price. While this Note has primarily focused on quarterly earnings guidance, this Section provides two recent examples of how companies are affected regardless of whether they issue quarterly or annual EPS guidance.

FedEx issues only annual EPS guidance. Nevertheless, when the company missed its guidance, it was faced with plummeting stock prices. Lululemon, on the other hand, provides quarterly guidance, and experienced rising stock prices following a quarter where it exceeded its EPS estimate. These examples are designed to demonstrate that regardless of whether a company issues annual or quarterly EPS guidance, the company will remain focused on meeting its short-term earnings.

1. FedEx

FedEx, a global shipping company, reaches more than 220 countries, linking more than 99% of the world's GDP.[130] FedEx employs over 400,000 team members throughout the world and is consistently named as one of the

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128 *See infra* Part V.

129 In this Part, I simplify the effects of company performance by arguing that when a company exceeds its EPS guidance, its share price will rise, and when a company misses its EPS guidance, its share price will decline. However, I do not take into account the many other factors that may result in the company's share price rising or falling.

130 *Our Story*, FEDEX, https://about.van.fedex.com/our-story/ (last visited Apr. 8, 2019).

best places to work.[131] The third quarter of 2019 resulted in a less-than-ideal situation for FedEx, a company ranked in the Top 50 of the Fortune 500 and named in the Top 10 of the World's Most Admired Companies by Fortune.[132] FedEx, like many companies, issues *annual* EPS guidance, and while FedEx itself does not provide quarterly EPS forecasts, Wall Street analysts do.[133]

In FedEx's last earnings report of fiscal year 2018, it projected annual earnings for 2019 ranging from $17.00 to $17.60 per share.[134] Following reports that FedEx experienced higher first quarter results, FedEx, in its earnings report for the first quarter of 2019, increased the projected annual earnings to $17.20 to $17.80 per share.[135] However, during the second quarter, FedEx reported a decrease in international business, resulting in the company significantly reducing its annual earnings to $15.50 to $16.60 per share.[136] Disclosed in FedEx's earnings report were "Cost-Reduction Actions" that the company would take to mitigate below-plan performance.[137] Such actions included limiting hiring in staff functions and reductions in discretionary spending.[138] As discussed in Part IV, management engages in a variety of cost-cutting tactics in an effort to avoid missing earnings guidance.[139] However, even with management taking mitigating actions, in the third quarter, FedEx again reported lower-than-expected financial reports and further reduced its annual EPS guidance to earnings of $15.10 to $15.90 per share.[140]

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131 *FedEx Named One of FORTUNE Magazine's 2018 Best Companies to Work For*, FEDEX (Feb. 15, 2018), https://about.van.fedex.com/newsroom/fedex-named-one-of-fortune-magazines-2018-best-companies-to-work-for/.

132 *See 47: FedEx*, FORTUNE 500, http://fortune.com/fortune500/fedex/ (last visited Apr. 7, 2019); *FedEx Earns No. 10 Spot on the FORTUNE World's Most Admired Companies List*, FEDEX (Jan. 22, 2019), https://about.van.fedex.com/newsroom/fedex-earns-no-10-spot-on-the-fortune-worlds-most-admired-companies-list/.

133 *FedEx Corp.*, MARKETWATCH, https://www.marketwatch.com/investing/stock/fdx/analystestimates (last visited Apr. 9, 2019) (providing analyst estimates).

134 Press Release, FedEx, FedEx Corp. Reports Fourth Quarter and Full-Year Earnings (June 19, 2018), http://investors.fedex.com/news-and-events/investor-news/news-release-details/2018/FedEx-Corp-Reports-2018-Fourth-Quarter-and—Full-Year-Earnings/default.aspx.

135 Press Release, FedEx, FedEx Corp. Reports Higher First Quarter Earnings, Increases Fiscal 2019 Earnings Per Share Outlook (Sept. 17, 2018), http://investors.fedex.com/news-and-events/investor-news/news-release-details/2018/FedEx-Corp-Reports-Higher-First-Quarter-Earnings-Increases-Fiscal-2019-Earnings-Per-Share-Outlook/.

136 Press Release, FedEx, FedEx Corp. Reports Second Quarter Results (Dec. 18, 2018) [hereinafter Press Release, FedEx Second Quarter], http://investors.fedex.com/news-and-events/investor-news/news-release-details/2018/FedEx-Corp-Reports-Second-Quarter-Results/.

137 *Id.*

138 *Id.*

139 *See infra* Part IV.

140 Press Release, FedEx, FedEx Corp. Reports Third Quarter Results (Mar. 19, 2019) [hereinafter Press Release, FedEx Third Quarter], http://investors.fedex.com/news-and-

Shortly after FedEx reported its third quarter results showing yet again a significant reduction in its 2019 EPS forecast, FedEx's stock price began tumbling.[141] While it is inevitable that stock prices will fluctuate when companies are faced with difficulties, FedEx's CEO specifically drew attention to the fact that the company's financial results fell below its "expectations."[142] Therefore, while stock prices may have fallen due to market concern, management's overestimation and subsequent adjustments likely led to increased volatility. The continual adjustments to FedEx's projected annual earnings guidance and cost-reducing strategies demonstrate the company's desire to meet its short-term earnings while minimizing potential damage resulting from the company's declining stock prices.

2. Lululemon

In July 2007, Lululemon, a popular athletic-wear brand, raised $327.6 million in its initial public offering.[143] In 2014, Fortune named Lululemon as one of the Top 100 fastest-growing companies.[144] Today, Lululemon remains one of the most recognizable, innovative brands for athleisure apparel.[145]

As a relatively new public company, in an attempt to foster communications and demonstrate its growth and success, Lululemon provides investors with quarterly EPS guidance.[146] The company provides quarterly EPS guidance and results in the form of quarterly investor calls and company press releases.[147] In Lululemon's 2019 third quarter earnings report, the company projected earnings per share for the fourth quarter to be in the range of $1.64 to $1.67.[148] In Lululemon's fourth quarter earnings report, the company disclosed it had exceeded the company's EPS estimate and reported

events/investor-news/news-release-details/2019/FedEx-Corp-Reports-Third-Quarter-Results/.

141 Teresa Rivas, *FedEx Stock Is Tanking After Earnings and Guidance Fall Short of Lowered Expectations*, BARRON'S (Mar. 19, 2019), https://www.barrons.com/articles/fedex-stock-is-tanking-after-earnings-and-guidance-fall-short-of-lowered-expectations-51553030936.

142 *See* Press Release, FedEx Third Quarter, *supra* note 140.

143 *LuLulemon's IPO Prices at $18/shr-underwriter*, REUTERS (July 26, 2007), https://www.reuters.com/article/lululemon-ipo-idUSWEN980820070726.

144 *Fastest-Growing Companies 2014: Lululemon Athletica*, FORTUNE, https://fortune.com/100-fastest-growing-companies/2014/lululemon-athletica/ (last visited Apr. 10, 2019).

145 *See Proof that Lululemon Is More Influential Than You Even Knew*, WELL & GOOD (July 22, 2016), https://www.wellandgood.com/good-looks/sweat-equity-jason-kelly-lululemon/ (providing Lululemon's history and noting its rise to global recognition and popularity).

146 Press Release, Lululemon, Lululemon Athletica Inc. Announces Third Quarter Fiscal 2018 Results (Dec. 6, 2018) [hereinafter Press Release, Lululemon Third Quarter], http://investor.lululemon.com/news-releases/news-release-details/lululemon-athletica-inc-announces-third-quarter-fiscal-2018-0.

147 *See generally Investor Relations*, LULULEMON, http://investor.lululemon.com/ (last visited Apr. 1, 2019).

148 Press Release, Lululemon Third Quarter, *supra* note 146.

earnings per share of $1.85.[149] Further, Lululemon exceeded analysts' fourth quarter projection of $1.74 per share.[150] Shares of Lululemon jumped ten percent following Lululemon's fourth quarter earnings.[151]

Lululemon also faces an additional pressure and increased desire to beat its EPS guidance. As Lululemon continues to exceed EPS guidance, the company is building consecutive quarters where the guidance has been met. Therefore, because of such consecutive success, if the company were to miss its guidance, it is likely share volatility will be much greater than a company without such a consistent basis for meeting its guidance.

IV. Management's Myopic Behavior

Corporate executives are often faced with pressure to meet quarterly earnings resulting in more time spent on producing short-term results rather than long-term strategy. Management often responds to the pressure of meeting quarterly earnings by minimizing funding from research and development and other long-term investment opportunities.[152] In a 2014 study, sixty-three percent of companies surveyed reported an increase in pressure for executives to generate short-term financial results over the past five years.[153] Concerns are often raised regarding many common practices management uses in order to meet the company's projected earnings.[154] Additionally, when a company utilizes these practices, many shareholders are completely unaware of such manipulation, as they solely rely on EPS guidance for evaluating the company's health. Management's behavior in response to the company's issuance of EPS guidance, not simply the estimate itself, is driving short-termism and leading to long-term underperformance.[155]

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149 Press Release, Lululemon, Lululemon Athletica Inc. Announces Fourth Quarter and Full Year Fiscal 2018 Results; Board of Directors Authorizes $500.0 Million Stock Repurchase Program (Mar. 27, 2019) [hereinafter Press Release, Lululemon Fourth Quarter], http://investor.lululemon.com/news-releases/news-release-details/lululemon-athletica-inc-announces-fourth-quarter-and-full-16.

150 Maggie Fitzgerald, *Lululemon Shares Soar 10% as Strong Holiday Sales Fuel Earnings Beat*, CNBC (Mar. 27, 2019), https://www.cnbc.com/2019/03/27/lululemon-fourth-quarter-2018—earnings.html.

151 *Id.*

152 *Short-Termism: Overview*, CFA Inst., https://www.cfainstitute.org/en/advocacy/issues/short-termism (last visited Apr. 7, 2019).

153 Jonathan Bailey et al., CPP Inv. Bd. & McKinsey & Co., Short-Termism 2 (2014), https://www.fcltglobal.org/docs/default-source/default-document-library/20140123-mck-quarterly-survey-results-for-fclt-org_final.pdf?sfvrsn=5078258c_0.

154 *See id.* at 5–7.

155 Heitor Almeida, Is It Time to Get Rid of Earnings-Per-Share (EPS)? (Oct. 2018) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3291497.

A. *Reduce Discretionary Spending*

Reducing discretionary spending is a common tactic used by companies when faced with the possibility of missing earnings forecasts. In a 2016 study, researchers asked corporate executives what they would do if it were near the end of a quarter and it looked as if the company would miss its earnings target.[156] In response, there was a sharp divide between companies that had preexisting cultures of valuing long-term growth versus companies where long-termism was not a major part of their culture.[157] The study revealed that 45% of companies that reported valuing long-termism would reduce discretionary spending to avoid missing quarterly earnings targets, while 71% of companies who did not report valuing long-termism would slash such spending.[158] Additionally, only 33% of long-term oriented companies would delay starting a project, even if value was sacrificed, in order to avoid a quarterly earnings miss, compared to 55% of companies that did not report to value long-termism.[159] This study demonstrates companies that have some sort of long-term value creation plan in existence are significantly less likely to reallocate long-term expenditures to avoid missing EPS guidance. Companies that do have long-term strategies in place may still engage in short-termism to meet earnings projections; however, they likely do so less frequently and are likely motivated to replenish funding for the long-term projects. While it is clear that companies struggle to keep long-term growth at the top of their priorities, companies that have no long-term value proposition remain solely focused on meeting short-term earnings.

Reductions in spending are made by cutting funding on research and development, advertising, other investments, and through postponing hiring.[160] For example, in the FedEx example in Part III, once the company began reducing its annual EPS guidance, FedEx also implemented measures such as limiting hiring in staff functions and reducing discretionary spending.[161] While there may be additional reasons for companies to cut spending, such as internal operations difficulties, companies that provide EPS guidance likely have an additional motive for minimizing long-term expenditures: to avoid missing the projection. Additionally, companies can manage other expenses by cutting the travel budget, delaying or canceling software spending, or deferring maintenance spending.[162] This trend in reducing research and development expenditures is further evidenced by the fact that companies that *just meet* their EPS forecast have significantly lower research

156 DOMINIC BARTON ET AL., FCLTGLOBAL, RISING TO THE CHALLENGE OF SHORT-TERMISM 8 (2016), https://www.fcltglobal.org/docs/default-source/default-document-library/fclt-global-rising-to-the-challenge.pdf.

157 *Id.*

158 *Id.*

159 *Id.*

160 Graham et al., *supra* note 17, at 40.

161 Press Release, FedEx Second Quarter, *supra* note 136; *see also supra* Part III.

162 Graham et al., *supra* note 17, at 40.

and development expenditures.[163] A recent study looked at companies that just meet their EPS guidance accompanied with cuts in discretionary spending in contrast to companies that just miss their EPS guidance but continue to increase their discretionary spending.[164] This study indicates that companies that just meet or just miss their EPS guidance have the discretionary choice to engage in myopic behavior and manipulate earnings to meet the guidance.[165] This suggests that one way to determine if the company is behaving myopically is to look at a company's discretionary spending in relation to meeting or missing its EPS guidance.[166] For example, a company may be behaving myopically if it just meets its projection and has reductions in discretionary expenditures, while a company that just misses its EPS projection while increasing or maintaining its discretionary expenditures is likely not engaging in short-termism. However, perhaps due to the breadth of available reductions in discretionary expenditures, there remains a relatively low number of companies that report just missing their EPS guidance.[167] Therefore, because of the low number of companies that report just missing their EPS, the companies reporting an increase in discretionary expenditures are likely those that clearly exceed or clearly miss their guidance. Overall, it is evident companies take advantage of the opportunity to cut spending from line items—particularly those funding long-term growth—in order to opportunistically meet the short-term goal of meeting the company's EPS guidance.

B. Channel Stuffing

An additional practice management may engage in to meet short-term earnings is a practice called channel stuffing.[168] Channel stuffing refers to the practice of management selling excess units of inventory and reporting higher sales in order to obtain favorable short-term reaction.[169] The primary purpose of engaging in channel stuffing is to make the company's financial performance appear healthier than it is.[170] Channel stuffing is frowned

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163 Almeida, *supra* note 155. For example, if a company's EPS guidance was $5.05, and the company reports $5.08, that company may have less research and development expenditures than a company that missed its guidance and reported $5.03.

164 Sanjeev Bhojraj et al., *Making Sense of Cents: An Examination of Firms That Marginally Miss or Beat Analyst Forecasts*, 64 J. FIN. 2361, 2362–63 (2009).

165 *Id.*

166 *Id.*

167 Almeida, *supra* note 155.

168 *See* Letter from James J. Angel to U.S. Sec. & Exch. Comm'n, *supra* note 48, at 3.

169 Guoming Lai et al., Manager Incentives for Channel Stuffing with Market-Based Compensation 2 (Jan. 2009) (unpublished manuscript), https://www.researchgate.net/publication/228525745_Manager_Incentives_for_Channel_Stuffing_with_Market-Based_Compensation.

170 *What's Channel-Stuffing and Is It a Crime?*, MOLOLAMKEN LLP (last visited Oct. 20, 2019), http://www.mololamken.com/news-knowledge-30.html.

upon by the SEC as it misleads investors through accelerating earnings to reach the company's targeted EPS.[171]

This practice likely has a detrimental impact on future quarters and long-term success as the companies receiving the excess inventory are unlikely to sell the excess product, and will have to use it in a future quarter, thereby diminishing the company's sales for those quarters.[172] While investors may be able to see a reduction in research and development expenditures on the company's Form 10-Q and correlate the reduction to the company just meeting its EPS guidance, it is much less likely an investor would be able to identify a company's practice of engaging in channel stuffing to meet its EPS guidance.

C. *Stock Buyback*

There are many reasons companies may decide to buy back stock from its investors. A company often phrases its decision to repurchase stock as being in the best interests of its shareholders because the company's stock is its most valuable asset and investment. However, companies may also repurchase stock in order to manipulate earnings and, therefore, appear to meet its EPS guidance. A stock repurchase reduces the number of outstanding shares of stock, which, when calculating EPS (total earnings divided by outstanding shares), results in a short-term increase to the result.[173] While shareholders would likely welcome this buyback as it would appear to increase the company's EPS, this practice is also in the self-interest of the managers as it prevents the company from missing its EPS forecast, which subsequently would result in a reduction in stock price. In a 2018 speech, SEC Commissioner Robert J. Jackson Jr. discussed a self-serving reason management may repurchase stock.[174] He stated that "there is clear evidence that a substantial number of corporate executives today use buybacks as a chance to cash out the shares of the company they received as executive pay."[175] While a stock repurchase provides an immediate result, when a company conducts the repurchases, it is in effect taking capital from its long-term growth opportunities, such as research and development, thereby inadvertently promoting short-termism.[176] Similar to a reduction in discretionary

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171 Adam Hayes, *Channel Stuffing*, INVESTOPEDIA (last updated May 4, 2019), https://www.investopedia.com/terms/c/channelstuffing.asp.

172 *Id.*

173 For example, if a company initially had earnings of $75,000 and 10,000 outstanding shares, the EPS would be $7.50. However, if the company repurchases 5000 shares, EPS would increase to $15.00.

174 Robert J. Jackson Jr., Comm'r, U.S. Sec. & Exch. Comm'n, Speech at the Center for American Progress: Stock Buybacks and Corporate Cashouts (June 11, 2018), https://www.sec.gov/news/speech/speech-jackson-061118.

175 *Id.*

176 *See* Roger L. Martin, *Stock Buybacks Are a Problem But the Sanders-Schumer Solution Is Not the Answer*, BARRON'S (Feb. 7, 2019), https://www.barrons.com/articles/stock-buybacks-ban-wont-fix-the-problem-51549495689; *see also* Robert Barone, *Buybacks: The New Magic*

expenditures, companies that are just about to miss their EPS forecast have significantly higher stock repurchases than companies that will meet the forecast without the need for repurchases.[177] A 2006 empirical study on whether companies strategically use repurchases to meet EPS guidance demonstrated that a disproportionately large number of companies would have missed their EPS guidance without such a repurchase.[178]

Companies that exceed their EPS guidance may also announce plans for stock repurchases. Because managers are motivated to beat guidance in order to build credibility and preserve their reputation, companies strategically use repurchases to maintain such standing. For example, following a quarter where Lululemon exceeded its EPS guidance, the company announced that its Board of Directors authorized a $500 million stock repurchase plan.[179] The Board stated that the "stock repurchase program is intended to create shareholder value by making opportunistic repurchases during periods of favorable market conditions."[180] While there are many reasons a company may repurchase stock, including that the company's stock may be superior to any other long-term investments, the repurchase itself has the effect of increasing EPS. Historically, Lululemon has repurchased its own shares; for example, the company repurchased 4.9 million shares of its own common stock at an average cost of $121.10 per share in 2018.[181] Because of Lululemon's traction and consecutive quarters of meeting EPS guidance, management is greatly incentivized to ensure the company continues to meet or exceed the guidance. Lululemon's stock repurchase plan demonstrates the company's desire to meet or exceed short-term earnings, and such plan provides the company with the flexibility to manipulate its earnings per share.[182]

V. Elimination of EPS to Assist in Deterring Short-Termism

Management is stuck in a toxic cycle of overestimating EPS guidance. As we have seen, such overestimates result in the impairment of long-term initiatives to bolster short-term earnings. However, if management instead predicts low EPS guidance with the plan to exceed its estimates, it is likely the market would react to the disappointing forecast based on the underestimate

Beans, Forbes (May 20, 2018), https://www.forbes.com/sites/greatspeculations/2018/05/20/buybacks-the-new-magic-beans/#6b35bb5b2dc2 (discussing how buybacks also make companies more leveraged and thus more risky).

177 Almeida, *supra* note 155.

178 Paul Hribar et al., *Stock Repurchases as an Earnings Management Device*, 41 J. Acct. & Econ. 3, 3 (2006).

179 Press Release, Lululemon Fourth Quarter, *supra* note 149; *see also supra* notes 146–47 and accompanying text.

180 Press Release, Lululemon Fourth Quarter, *supra* note 149.

181 *Id.*

182 It is worth noting that it is possible Lululemon authorized this stock repurchase plan as a precautionary measure for the company to maintain and continue to exceed its EPS guidance for future quarters.

and similarly cause stock prices to shift downward.[183] In order for public companies to break the cycle of short-termism, management must cease the practice of providing EPS guidance and instead focus on long-term growth initiatives that are in both the company's and investors' best interests. This Part provides one alternative to EPS guidance that may be an additional factor to deterring short-termism—long-term roadmaps.

A. *Long-Termism*

The desire to meet EPS guidance has long incentivized management to focus on short-term earnings at the expense of long-term growth. The various tactics used by management to meet EPS guidance demonstrates the myopic behavior that occurs in order to avoid missing short-term earnings. When management reduces discretionary spending, engages in channel stuffing, or repurchases stock, the company has reallocated long-term growth expenses to optimize short-term performance. Eliminating EPS guidance will remove pressure to meet short-term earnings and prevent management from detracting long-term resources to meet such goals.

The need to meet or exceed EPS guidance creates a parasitic relationship between short-term and long-term goals, where short-term goals always take precedent. Eliminating EPS guidance will allow management the opportunity to foster long-term growth without the pressure to reallocate resources to meet current EPS guidance. Further, by maintaining the current reporting system, a company that encourage long-term thinking and investment will create value for its shareholders without sacrificing transparency.

B. *Shareholder Primacy*

Eliminating EPS guidance will allow management to act in the best interest of the company's shareholders and therefore fulfill the shareholder primacy norm. When management meets quarterly EPS guidance by engaging in practices that result in the reallocation of capital, such reallocations may appear to be in the best interests of the shareholders at the time but may actually have negative long-term effects. Eliminating EPS guidance will prevent management from reallocating resources, and thus shift more focus to sustaining long-term investments. Moreover, a cultural shift has led investors to value factors other than simply their return on investment. As investors' interests now include long-term investment in ESG and other socially responsible investments, investors are likely to be unaffected by the elimination of EPS guidance as their interests are primarily centered around long-term growth rather than short-term earnings. Therefore, in order for management to adequately represent and act in the shareholder's best interest, management must also devote resources to pursing long-term ESG and socially-

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183 *See, e.g.*, Amelia Lucas, *Lululemon Earnings Beat, But Shares Drop 3% on Weak Fourth-Quarter Outlook*, CNBC (Dec. 6, 2018), https://www.cnbc.com/2018/12/06/lululemon-earnings-q3-2018.html.

responsible initiatives. Eliminating EPS guidance will encourage management to align its interests with investors' interests in long-term sustainability while disincentivizing management's short-term financial prerogatives.

C. Long-Term Roadmaps

Long-term roadmaps are a form of investor communication that "present a unified view of how a company will create long-term value with the most relevant metrics to track long-term performance."[184] Long-term roadmaps facilitate the shift of communications with investors away from quarterly EPS "hits" and "misses" and toward how the company will create long-term value.[185] Replacing EPS guidance with long-term roadmaps will allow a company to align its investors' interests with the company's long-term objectives. In a long-term roadmap, the company should discuss more than just its mission and business model—it should also include a detailed strategic plan, long-term objectives, and metrics for tracking progress.[186] Additionally, a company's long-term roadmap should include a clear vision for the company's plan for the next three to five years based on the company's competitive advantages and how the company's business model will function to create long-term growth.[187] Such detailed tracking capabilities will promote transparency and allow investors to continue to monitor the company's progress in fulfilling the long-term goals.

Many companies, including BP and Home Depot, have transitioned from providing EPS guidance to providing investors with long-term roadmaps.[188] These companies worked to provide investors with a clear picture of how the shift to a long-term roadmap would build on the company's strengths to execute the company's long-term goals.[189] Further, companies that have implemented long-term roadmaps have reported that this approach of communicating long-term objectives has allowed them to speak to issues the majority of investors find relevant.[190]

Providing investors with a long-term roadmap focused on the company's long-term strategy, including specific financial metrics, will provide investors sufficient confidence and transparency into the company's future financial health while preventing management from engaging in short-term myopic behavior.[191]

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184 BABCOCK ET AL., *supra* note 118, at 4.

185 *Id.*

186 *Id.* at 9.

187 *Id.*

188 *Id.* at 10–14; *see, e.g.*, *Case Study: Effective Investor Roadmaps from The Home Depot*, FCLTGLOBAL (Mar. 5, 2019), https://www.fcltglobal.org/news/blog/article/2019/03/05/case-study-effective-investor-roadmaps-from-the-home-depot.

189 BABCOCK ET AL., *supra* note 118, at 9.

190 *Id.* at 10.

191 BABCOCK & WILLIAMSON, *supra* note 118, at 4.

Conclusion

Eliminating EPS guidance will not by itself eliminate all short-term pressures facing management, but it will be a step in the right direction toward promoting long-term growth. During the SEC's investigation into whether the current reporting system fosters short-term behavior, it is likely the SEC will find that it is not the frequency of disclosures that encourages excessive focus on short-termism but rather management's voluntary issuance of EPS guidance that promotes the subsequent myopic behavior. Eliminating EPS guidance will detract from management's excessive focus on short-termism resulting from the need to meet EPS projections. As shareholders' evaluations of their portfolios have broadened to include nonfinancial factors such as a company's commitment to ESG and long-term sustainability, management must echo these interests to fulfill the shareholder primacy norm. Substituting management's issuance of EPS guidance with long-term roadmaps will align the investors and company's interests while providing management with the flexibility needed to facilitate long-term growth.