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Letters to the shareholders: A content analysis comparison of letters written by CEOs in the United States and Japan

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Abstract

Previous studies suggest that letters to the shareholders are widely used in investors' decision-making processes. Letters to the shareholders, however, are unaudited and usually not subject to regulation. Hence, CEOs may use them strategically to manage the impressions shareholders have of the company. This paper focuses on letters to the shareholders from Japanese and U.S. companies. The research examines whether U.S. and Japanese CEOs explain the causes of good and bad news in different ways. The findings point to a number of interesting differences between the U.S. and Japanese letters to the shareholders, including: (1) that U.S. CEOs in particular emphasize good news; (2) that Japanese and U.S. letters are statistically indistinguishable with respect to the extent to which CEOs claim responsibility for good news; and (3) that while CEOs in general ascribe bad news to causes beyond their control, this tendency is particularly strong in Japanese letters. The implications of the study for both investors and regulators are discussed.

Keywords: Letter to the shareholders; Impression management; Comparative reporting; United States; Japan

1. Introduction and motivation

The objective of this paper is to examine whether U.S. and Japanese CEOs address company performance differently in their letters to the shareholders.[1] The letter to the shareholders is usually not subject to regulation, and the auditor's role remains limited to

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[1] The term "letter to the shareholders" or "letter" also covers similar documents such as the "chairman's statement or address" and the "president's letter" as well.

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verifying that the information in it is consistent with the numbers presented in the financial statements (Clatworthy & Jones, 2003; Nobes & Parker, 1998).[2] Hence, it provides management with an excellent opportunity to manage the impressions outsiders have of the company without having to worry too much about regulatory repercussions. Prior research indicates that U.S. CEOs utilize this opportunity by using a self-serving attributional bias (e.g., Bettman & Weitz, 1983; Staw, McKechnie & Puffer, 1983; Lee, Peterson & Tiedens, 2004). This implies that they are inclined to explain good news (e.g., an increase in profits) in terms of internal causes such as the corporate strategy and investment decisions. However, it also means that they are likely to ascribe bad news to adverse general economic conditions, the weather, or other causes beyond management's control. More recent studies demonstrate that European CEOs also address company performance in a self-serving fashion by ascribing good news to themselves and by blaming bad outcomes on the external environment (Aerts, 1994, 2005; Clatworthy & Jones, 2003).

The importance of the letter to the shareholders is well documented. Studies in various countries demonstrate that accounting narratives and especially the letter to the shareholders are particularly useful and important parts of the annual report (Bartlett & Chandler, 1997; Epstein & Pava, 1993). For example, Bartlett and Chandler (1997) show that of the various sections of the annual report, the letter to the shareholders is the most thoroughly read by private investors and ranked second in overall importance. Furthermore, several other studies suggest that the letter can influence private investors' decisions (e.g., Kaplan, Pourciau & Reckers, 1990; Baird & Zelin, 2000). Baird and Zelin (2000), for example, find that the order in which positive and negative information is presented in the letter significantly influenced investors' decisions.

Although the letter seems particularly important for private investors, also more sophisticated users, such as financial analysts, do seem to use it. For example, Breton and Taffler (2001, p. 99) find that analysts rely on "non-financial, soft, qualitative and impressive information in making stock recommendations." Additionally, it seems that CEOs' explanations for company performance affect analysts' forecasts. For example, Barton and Mercer (2005) conduct an experiment with financial analysts to investigate their reactions to external explanations for poor financial performance. They demonstrate that implausible explanations backfire and lead analysts to provide lower earnings forecasts and to assess a higher cost of capital than if the explanation had not been provided. Plausible explanations, however, did not improve management's reputation with analysts, suggesting that analysts expect managers to provide plausible performance explanations.

The present study examines the fashion in which firm performance is addressed in letters to the shareholders from the world's two largest capital markets: the United States and Japan. These two countries are considered important not only for the development of accounting (Nobes & Parker, 1998), but also because the cultural values predominating in these countries are dissimilar (e.g., Hofstede, 2001). Prior studies have demonstrated that as

[2] International Auditing Standard (ISA) 720 addresses the auditor's responsibilities relating to other information containing audited financial statements. Among others, ISA720 indicates that the auditor's opinion does not cover other information, and the auditor has no specific responsibility for determining whether or not other information is properly stated. However, according to ISA720 the auditor must read the other information because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information.