ABSTRACT

This study investigates the impact of voluntary disclosure in the form of management earnings guidance on post-earnings announcement drift (PEAD). Prior research contends that investors’ delayed response to the information contained in earnings contributes to PEAD. This delayed response occurs because either investors fail to understand the full implications of current earnings for future earnings or transactions costs prevent a complete and immediate response to earnings news. To the extent that management earnings guidance (MEG) overcomes these shortcomings, I examine three research questions. First, does MEG mitigate PEAD? Second, what is causal channel through which MEG mitigates PEAD? Third, is the impact of MEG on PEAD sensitive to the quality of MEG? Using management earnings guidance data from First Call for the period between 1996 and 2006, I show that MEG mitigates PEAD. I also find that MEG not only improves the extent to which investors incorporate prior earnings information into their earnings expectations but also provides information about future earnings which is uncorrelated with prior earnings information. Further, I find the mitigation effect of guidance on PEAD increases with guidance quality in terms of precision, accuracy, and usefulness. Overall, my study provides evidence on the effectiveness of voluntary disclosure and the channel through which it can alleviate the accounting anomaly of PEAD.