

ACCOUNTING INFORMATION AND CORPORATE GOVERNANCE
Market and Analyst Reactions to Earnings of Firms
Engaged in Proxy Contests*

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This paper studies market and analyst reactions to earnings (i) during a proxy contest for board seats and (ii) after a proxy-contest-induced management change. Despite indications of earnings management during the proxy contest, market and analyst reactions are more pronounced than in prior periods, and earnings surprises explain more of the cross-sectional variation in these reactions. Market and analyst reactions to earnings released after a successful proxy contest are less pronounced than in prior periods and earnings surprises explain less of the variation in these reactions, perhaps due to new managements' tendency to take an earnings 'bath'.

1. Introduction

Recent empirical research indicates that accounting information plays a role in the corporate governance process through which managerial inefficiency is discovered and punished. DeAngelo (1988a) finds that dissident stockholders who attempt to unseat management via a proxy contest typically cite poor accounting performance as evidence of managerial incompetence, and that managers apparently respond by overstating earnings during an election campaign. Weisbach (1988) finds that the probability a Chief Executive Officer (CEO) is forcibly ousted by the board of directors increases with poor accounting performance. In the logit model he uses to predict CEO turnover, prior-period earnings have greater explanatory power than current

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earnings or stock returns. Weisbach posits that the low explanatory power for current earnings reflects managers' tendency to inflate earnings in their last year in attempts to save their jobs.

These findings suggest two competing predictions about market and analyst reactions to earnings of firms whose managers are threatened with involuntary termination (e.g., via proxy contest, board-instigated management change, or hostile tender offer). First, a contest for corporate control increases investor uncertainty about who will manage the firm in future periods, hence about its future direction and cash-flow prospects. In such contexts, earnings reports can be especially useful to outsiders attempting to predict this direction – e.g., higher-than-expected earnings can increase investors' assessments that incumbent management has the ability to turn the company around and to sustain higher profits in the future. To the extent a proxy contest heightens investor uncertainty and earnings reports are useful in resolving that uncertainty, we expect that market and analyst reactions to earnings released during a proxy contest should be more pronounced than usual. This prediction is consistent with the evidence in Lang (1989) and Rao (1989), who find greater information content to earnings when there is greater uncertainty about a firm's future prospects.

On the other hand, dissident stockholders typically use reported earnings to argue for managerial termination [DeAngelo (1988a)], thereby providing managers with incentives to overstate earnings during a proxy contest. While it is conceivable that such overstatement makes earnings more informative [because it better conveys managers' inside information about future profits, as argued, e.g., by Myers and Majluf (1984)], one naturally expects managed earnings to be less informative. If analysts and other market participants perceive that earnings are artificially inflated during a proxy contest, their reactions should be dampened at that time. This latter prediction is consistent with the models in Holthausen and Verrecchia (1988) and Choi and Salamon (1989), which posit an inverse relation between a firm's earnings-response coefficient and the perceived noise in earnings [see also Collins and Salatka (1989)].

Our first set of results indicates that, despite evidence of earnings management during the election campaign, market and analyst reactions to earnings released during a proxy contest are more pronounced than they are in prior periods. Moreover, earnings surprises explain more than twice the cross-sectional variation in the stock-price reaction to earnings during the proxy contest than they do in the pre-contest period, and almost seven times the variation in analysts' forecast revisions. These findings suggest that, despite the increased noise induced by earnings manipulation, the predominant effect of earnings released during a proxy contest is to aid the corporate governance process by enabling outsiders to better evaluate managerial performance and/or to predict the contest outcome. Thus, our first set of

results supports the 'efficient contracting' perspective described in Watts and Zimmerman (1990).

Our second set of results indicates that market and analyst reactions to earnings are less pronounced after a proxy-contest-induced management change than they are in the pre-contest period. Like prior research [Moore (1973), DeAngelo (1988a)], we find that new managers tend to take an earnings 'bath'. We also find that earnings surprises explain only one-third the cross-sectional variation in the stock-price reaction to earnings after a successful proxy contest as in the pre-contest period, and essentially none of the variation in analysts' forecast revisions. We interpret our second set of results as indicating that income management after a proxy-contest-induced management change renders reported earnings less informative than in prior periods for these sample firms.

Section 2 describes sample-selection procedures and the time sequence of proxy-contest events. Sections 3 and 4 provide evidence of earnings management during the contest, and of a greater market and analyst reaction to earnings than in the pre-contest period. Sections 5 and 6 provide evidence of post-contest earnings management for firms with a proxy-contest-induced management change, and of a lower market and analyst reaction to earnings than in the pre-contest period. Section 7 discusses methodological issues and presents sensitivity checks on our results. Section 8 concludes with a brief summary.

2. Sample selection and the timing of contest events

Our sample consists of 88 proxy contests for board seats¹ on 83 exchange-listed firms during the 18-year period 1970–1987. We initially combined the samples in DeAngelo (1988a) and DeAngelo and DeAngelo (1989), whose source documents are the *Weekly Bulletins* of the New York and American Stock Exchanges and the NYSE log book of counter-solicitations by nonmanagement groups. We augmented this sample with the 1986–1987 proxy contests from the *Weekly Bulletins* of both exchanges. The resultant sample consists of 113 proxy contests for board seats on 106 listed firms, which we reduced to 88 contests for 83 firms by deleting observations with no earnings announcement during the contest.²

¹There are two types of proxy contests, those for board seats and 'issue contests' in which dissident stockholders seek a stockholder vote on particular managerial policies (without attempting to elect directors). We focus on proxy contests for board seats because we are interested in the role of accounting information in managerial performance evaluation.

²We deleted 18 contests because there was no earnings release between the inception of dissident activity and the stockholder meeting, four contests because we were unable to isolate contest- or earnings-announcement dates, and three contests because earnings were announced at the meeting or settlement date.

Prior research [Dodd and Warner (1983), DeAngelo (1988a), DeAngelo and DeAngelo (1989)] finds that dissidents are successful – i.e., they elect at least a majority of the board – in one-quarter to one-third of the proxy contests for board seats on listed firms. DeAngelo and DeAngelo argue that a more appropriate definition of ‘success’ includes proxy-contest-induced management changes.³ In the current sample, 43 (49%) met this broader success criterion, including 13 contests that resulted in a change in CEO, President, and/or Chairman within three years (two years for 1987 contests) of the contest outcome, although the dissidents failed to win a majority of board seats.⁴ We employ this broader success criterion in our empirical tests.

Our tests employ the last (quarterly or annual) earnings released before the contested board election as the earnings most relevant for managerial performance evaluation.⁵ Our prediction is that market and analyst reactions at that time differ from normal for an earnings surprise of a given magnitude, where the magnitude of the surprise is measured relative to the most recent Value Line (VL) analysts’ forecast.⁶ In the ideal research design, unexpected earnings would reflect only *unconditional* analysts’ forecasts, that is, forecasts released before analysts knew a proxy contest was likely. Managers would (ideally) have knowledge of the impending proxy contest when they released earnings, thereby having the predicted incentives to manage earnings. In short, the ideal sequence of events is that (i) analysts forecast earnings, (ii) dissidents announce a proxy contest, and (iii) managers report earnings.

Unfortunately, the actual sequence of events doesn’t always fit this pattern. Proxy contests do not typically begin with an announcement that dissidents plan to nominate directors – rather, dissidents generally air their concerns publicly for some time before naming an opposition slate. Although the last earnings before the election always follows the first public indication of

³It also includes firms that are acquired due to the dissidents’ efforts. Acquired firms are typically excluded from our post-contest sample, however, because they do not report separate post-contest earnings.

⁴We consider all changes of CEO, President, or Chairman within three years (two years for 1987 contests) of contest outcome as indicating the contest was successful without adjustment for ‘normal’ retirements at age 65. DeAngelo and DeAngelo (1989), whose sample is a material subset of ours, report that only two of the 23 individuals in their sample who resigned did so close to the normal retirement age of 65 (and both individuals had been the targets of the dissidents’ campaigns). Hence, ‘normal’ retirement is not likely responsible for the large number of managerial resignations following proxy contests.

⁵The typical contested board election is held at the annual meeting, by which time incumbent managers have released first-quarter earnings. A full 72% of our sample fits this pattern. Details of reported earnings are often not disclosed until after the election [DeAngelo (1988a, fn. 21)], so that outsiders have a limited ability to ‘undo’ managers’ accounting choices.

⁶Healy and Palepu (1988) develop a similar hypothesis for firms that initiate or omit dividends – that the post-dividend change in *ERC* is dampened when unexpected earnings are calculated as the earnings change from the prior period.

dissident opposition in our sample, it precedes the announcement of the proxy contest in 22 cases (25%). Thus, managers of up to one-fourth of the sample may not have expected a proxy contest when they reported earnings, although there were certainly visible conflicts with dissident stockholders at the time. This fact indicates a bias against observing earnings management, since managers who anticipate a *future* control contest may understate current earnings to 'bank' accounting discretion for use in later periods.

Of the 55 contests for which we can obtain VL analysts' forecasts, the forecast precedes the first public indication of dissident activity in only 23 (42%) of the contests. Another 17 forecasts (31%) follow the inception of dissident activity, but precede the announcement of the proxy contest. The remaining 15 forecasts (27%) follow the contest announcement. Thus, we can be reasonably confident that our measure of unexpected earnings does not reflect analysts' knowledge of the proxy contest in less than one-half the sample. This fact biases our tests against finding differential market and analyst reactions during the contest, if analysts who are aware of an impending proxy contest adjust their earnings forecasts for the proxy-contest-induced factors we seek to observe.

We employ time-series models to generate expected earnings for the 33 contests for which analysts' quarterly earnings forecasts are not available for the relevant test period. While time-series forecasts do not suffer from the timing problems discussed above, they have (potentially more serious) problems of their own. First, when a given earnings realization includes writeoffs and other unusual items, both current and future forecasts errors are affected because time-series models do not adjust earnings for such items. Second, approximately one-third of our time-series sample has fewer than 30 quarterly earnings observations available, so that model parameters are estimated with relatively high standard errors. Finally, as in all studies that rely on lengthy data series, parameter instability can be a problem. All these factors introduce measurement error into our forecast error metrics that attenuates the slope in the return/unexpected earnings relation, and adversely affects the explanatory power of the model. On the other hand, the use of both analysts' and time-series forecasts allows us to investigate the extent to which our results are robust to different forecast agents/proxies.

3. Accruals, forecast errors, and analysts' revisions during the contest

Panel A of table 1 reports unexpected accruals during the proxy contest for the 68 sample firms with complete data for the last earnings released before the contested board election and for the year-earlier comparison period. Panels B and C report analysts' earnings forecast errors and forecast revi-

sions for the 55 of 88 (62.5%) sample contests for which we could obtain VL analysts' forecasts.⁷ These data are for the last earnings before the contested board election (the proxy-contest period) and for the five years ending with the inception of dissident activity (the pre-contest period). Panel D reports Foster time-series model forecast errors [see Foster (1977) for details] for the 33 contests for which quarterly earnings forecasts were not available from Value Line, I/B/E/S, Zack's, or Standard & Poor's Earnings Forecaster during our sample period.⁸ Of these 33 firms, a full 32 (97%) are ASE-listed.⁹

The panel A unexpected accruals are calculated under both a random-walk model and the alternative model developed by Bowen, Burgstahler, and Daley (1986) [see DeAngelo (1988a) for details]. They are standardized by total assets so that they are directly comparable to the results in DeAngelo (1988a). The panel B analysts' earnings forecast errors (*FE*) are calculated from VL one-quarter-ahead *EPS* forecasts as (actual – expected) earnings, and are scaled by stock price two days before the earnings announcement. The panel C analysts' one-quarter-ahead forecast revisions (*REV*) are calculated as

$$REV_q = E_q(EP S_{q+1}) - E_{q-1}(EP S_{q+1}), \quad (1)$$

and scaled by stock price two days before the quarter *q* earnings announcement. The panel D Foster time-series model forecast errors are also calculated as (actual – expected) earnings and deflated by stock price. The summary statistics reported in table 1 are the mean and deciles 1, 3, 5, 7, and 9 of each distribution.

The panel A unexpected accruals indicate that managers' accounting choices during the proxy contest are systematically income-increasing, consis-

⁷With five years of quarterly earnings for 55 proxy contests, there are potentially 1,100 firm/quarters in the pre-contest period. The number of data points underlying the table 1 results (936 for earnings forecast errors and 929 for analysts' forecast revisions) is less than 1,100 primarily because some firms were not followed for the entire period by Value Line and/or because of missing VL editions in our libraries.

⁸The number of data points underlying the panel D results (537) is less than five years of quarterly data times 33 firms (660) because some of the firms did not exist in the early part of our sample period or quarterly earnings were not available from Compustat or *The Wall Street Journal (WSJ)*.

⁹Of the 55 firms in our sample that are followed by analysts, only two (4%) are ASE-listed. These findings are consistent with those in Brennan and Hughes (1990), who report that the median number of analysts following NYSE firms is about five times larger than the median number following ASE firms.

Table 1

Unexpected accruals, earnings forecast errors, and analyst revisions during a proxy contest: 88 proxy contests for board seats on 83 listed corporations (1970–1987).

	Mean (<i>p</i> -value) ^e	Deciles ^f					%pos./%neg. (<i>p</i> -value) ^e
		1	3	5	7	9	
(A) <i>Unexpected accruals during contest</i> ^a (68 contests)							
Random-walk model	0.0138 (0.0155)	-0.0421	-0.0054	0.0045 (0.0285)	0.0231	0.0688	62:38 (0.0212)
Alternative model ^b	0.0182 (0.0003)	-0.0271	0.0009	0.0121 (0.0001)	0.0298	0.0784	77:23 (0.0010)
(B) <i>Analysts' earnings forecast errors</i> ^c (55 contests)							
Proxy-contest period (55 quarters)	0.0005	-0.0354	-0.0106	-0.0021	0.0065	0.0248	46:51
Pre-contest period (936 quarters)	-0.0110	-0.0400	-0.0085	-0.0015	0.0026	0.0160	40:55
<i>P</i> -value for difference	(0.0150)			(0.3040)			(0.2206)
(C) <i>Analysts' forecast revisions</i> ^d (55 contests)							
Proxy-contest period (54 quarters)	0.0043	-0.0211	-0.0042	0.0000	0.0000	0.0086	28:41
Pre-contest period (929 quarters)	-0.0120	-0.0274	-0.0054	0.0000	0.0000	0.0074	26:47
<i>P</i> -value for difference	(0.0199)			(0.3826)			(0.2709)
(D) <i>Foster time-series model forecast errors</i> ^f (33 contests)							
Proxy-contest period (33 quarters)	0.0120	-0.0217	-0.0016	0.0068	0.0148	0.0391	67:33
Pre-contest period (535 quarters)	0.0004	-0.0349	-0.0066	0.0001	0.0058	0.0301	51:49
<i>P</i> -value for difference	(0.1118)			(0.0157)			(0.0375)

^aData are for the 68 proxy contests with complete data available for the earnings released before the contested board election and for the year-earlier comparison period. Unexpected accruals are standardized by total assets. *P*-values in parentheses are for one-tailed tests that unexpected accruals are positive during the election campaign.

^bThis model employs the difference between net income and working capital from operations in the comparison period as a benchmark for 'normal' accruals. [See DeAngelo (1988a).]

^cData are for the 55 proxy contests for which Value Line earnings forecasts are available. Earnings forecast errors are calculated as (actual - expected), and are scaled by stock price two days before the earnings announcement.

^dData are for the 55 proxy contests for which Value Line earnings forecasts are available. Analysts' forecast revisions are the difference between the one-quarter-ahead earnings forecast after release of current earnings and the same forecast before release of current earnings, scaled by stock price two days before the current-earnings announcement.

^e*P*-values are one-tailed, to test for a significant difference in the indicated variable across the contest and pre-contest periods or to test that the proportion of positive unexpected accruals > 50% in panel A.

^fThe predicted earnings figure is primary *EPS* before discontinued operations and extraordinary items. Earnings forecast errors are calculated as (actual - predicted), and are scaled by stock price two days before the earnings announcement.

tent with the findings in DeAngelo (1988a).¹⁰ Under the random-walk model, mean unexpected accruals are 1.38% of total assets, and are positive at the 0.0155 level under a standard *t*-test. Median unexpected accruals are 0.45% of total assets and are also significantly positive, at the 0.0285 level under a Wilcoxon signed-rank test. Results under the alternative model are somewhat stronger – mean (median) unexpected accruals are 1.82% (1.21%) of total assets, significant at the 0.0003 (0.0001) level. Finally, the proportion of positive unexpected accruals is significantly greater than 50% under both models. Thus all accrual test results suggest that managers of firms engaged in proxy contests systematically overstate reported earnings to present a more favorable picture of their own performance to voting stockholders.

The panel B analysts' forecast errors (*FE/P*) provide some, although not overwhelming, evidence that earnings during the proxy contest systematically exceed analysts' forecasts more than is the case in the pre-contest period. The mean analysts' forecast error during the proxy contest is a positive 0.05%, versus -1.1% in the pre-contest period, and the difference is significant at the 0.0150 level (one-tailed) under a standard *t*-test. The median forecast error, however, does not differ significantly across periods, nor does the proportion of positive and negative forecast errors [although the proportion of positive forecast errors during the contest (46%) is greater than in the pre-contest period (40%)].

The panel D Foster model forecast errors, like the panel B analysts' forecast errors, are all in the predicted direction, although not all are statistically significant. For the Foster model forecast errors, all differences across the proxy-contest and pre-contest periods are significant except the difference in means (which is significant at the 0.1118 level). Specifically, the difference in medians is significant at the 0.0157 level, while the difference in the proportion of positive forecast errors is significant at the 0.0375 level. Thus, both analysts' and time-series forecast errors tend to be more positive during the proxy contest than in the pre-contest period, consistent with our accrual results that managers tend to overstate earnings released during a proxy contest.

The panel C analysts' forecast revisions (*REV/P*) provide some, but again not overwhelming, evidence that analysts tend to make greater-than-usual revisions in their next-quarter forecasts after observing earnings released during the proxy contest. The mean analysts' forecast revision is positive (0.43%) during the contest, and differs significantly from the mean revision in the pre-contest period (-1.2%) at the 0.0199 level. However, the median revision is zero in both periods, and the proportion of positive forecast

¹⁰The limitations of the accrual approach are well-discussed in the literature and will not be repeated here. The interested reader should see Healy (1985), Kaplan (1985), DeAngelo (1988a, b), and McNichols and Wilson (1988).

revisions does not differ significantly across periods. Overall, the table 1 data suggest that earnings released during the proxy contest are managed to portray incumbent managers in a more positive light, that analysts (and time-series models) do not fully anticipate such earnings management, and that analysts tend to revise their next-quarter forecasts more extensively than in prior periods in response to those earnings.

4. Market and analyst reactions to earnings during proxy contests

To test for a differential market reaction to earnings released during the proxy contest, we employ the following pooled cross-sectional regression model:¹¹

$$CAR(-1, 0)_{iq} = \gamma_1 + \gamma_2 GDUM_{iq} + \gamma_3 \frac{FE_{iq}}{P_{it-2}} + \gamma_4 \frac{GDUM * FE_{iq}}{P_{it-2}} + \varepsilon_{iq}. \quad (2)$$

GDUM is a dummy variable that takes on the value 0 if the earnings announcement occurs before the first public indication of dissident stockholder activity, and the value 1 if it is the last earnings released before the stockholder election. All other variables are as defined earlier.¹² We run separate regressions for the 55 contests with analysts' forecasts available (the Value Line, or VL, sample) and for the 33 contests for which we develop Foster model earnings predictions (the time-series sample).

To test whether analysts revise the subsequent quarter's earnings estimate to a greater (or lesser) degree after they observe earnings released during the

¹¹Although our primary interest is in testing for differential slopes or *ERC*'s during the proxy contest, eq. (2) allows for differential intercepts as well. One reason for doing so is that Dodd and Warner (1983) and DeAngelo and DeAngelo (1989) find evidence of positive pre-contest stock-price performance followed by indications of negative stock-price performance during the contest itself. Thus sample firms' average stock-price performance may differ in the proxy-contest and pre-contest periods, independent of the effect of earnings announcements on stock prices.

¹²The two-day excess return for the day before and day of the quarterly earnings announcement is taken from the CRSP Daily Excess Returns File, and is the difference between each stock's daily return and the return on a portfolio comprised of similar beta risk stocks. Beta values are calculated using the techniques described in Scholes and Williams (1977).

proxy contest, we estimate the following model analogous to eq. (2):

$$\frac{REV_{iq}(q+1)}{P_{it-2}} = \alpha_1 + \alpha_2 GDUM_{iq} + \alpha_3 \frac{FE_{iq}}{P_{it-2}} + \alpha_4 \frac{GDUM * FE_{iq}}{P_{it-2}} + \eta_{iq}. \quad (3)$$

$REV_{iq}(q+1)$ is the revision in the VL earnings forecast of firm i for quarter $q+1$ following the earnings announcement in quarter q calculated as described in eq. (1). The other variables are as described earlier.¹³ Consistent with the evidence in Easton and Zmijewski (1989), we expect α_3 to be positive. A priori, however, we are unable to predict the sign of α_4 . If, because of the proxy contest, analysts place increased emphasis on reported earnings to resolve uncertainty about the future direction of the firm, then α_4 should be positive. On the other hand, if analysts believe the numbers are unreliable due to earnings management, α_4 is expected to be negative.

Panel A of table 2 presents results of tests for a differential market reaction to earnings released during the proxy contest. Plots of the estimated ERC 's are presented in panel A of fig. 1. For the Value Line sample, the estimated ERC during the contest, $\hat{\gamma}_3 + \hat{\gamma}_4 = 0.535$, represents a nearly threefold increase over the estimated ERC of 0.184 in the pre-contest period. This difference is significant at $\alpha = 0.10$ (two-tailed test). For the time-series sample, the estimated ERC 's are somewhat smaller, 0.432 during the proxy contest and 0.039 in the pre-contest period (the latter is insignificantly different from zero). Nonetheless, the ERC during the contest is significantly positive and represents a ten-fold increase over the pre-contest ERC . The insignificant size of the time-series ERC (α_3) estimate during the pre-contest period reinforces our earlier point – that the difficulties inherent in using time-series models as a proxy for market earnings expectations two days before the earnings announcement attenuates ERC estimates toward zero.

For the VL sample, the adjusted R^2 over both periods is 5.1%, which is comparable to that reported in other short-window event studies [e.g., see Hagerman, Zmijewski, and Shah (1984)]. As panel A indicates, separate regressions for each time period yield an adjusted R^2 of 10.7% during the proxy contest versus 4.7% in the pre-contest period. Thus, earnings surprises explain more than twice the cross-sectional variation in the stock-price

¹³The procedure used to measure analysts' forecast revisions is analogous to that in Easton and Zmijewski (1989), except that we scale by stock price two days before the earnings announcement for quarter q while they regress forecast revisions on current-period forecast errors without scaling by stock price.

Table 2

Summary regression results for differential ERC's and revision coefficients for pre-contest vs. proxy-contest period: 88 proxy contests for board seats on listed firms (1970-1987).

Predicted sign	(A) $CAR(-1, 0)_{i,q} = \gamma_1 + \gamma_2 GDUM_{i,q} + \gamma_3 \frac{FE_{i,q}}{P_{i,t-2}} + \gamma_4 \frac{GDUM * FE_{i,q}}{P_{i,t-2}} + \epsilon_{i,q}^a$						F-value (sig. level)	Adj. R ²	N	Adj. R ² 's separate regressions
	γ_1	γ_2	+	γ_3	?	γ_4				
Value Line sample (55 contests)	-0.002 (-1.215) ^b	0.007 (0.991)	0.184 (6.870)***	?	0.351 (1.696)*	?	18.567 (0.0001)	0.051	983	Pre-contest = 0.047 Contest period = 0.107
Time-series sample ^c (33 contests)	-0.001 (-0.262)	0.019 (1.667)*	0.039 (1.228)	+	0.393 (1.701)*	?	3.256 (0.0134)	0.013	499	Pre-contest = 0.001 Contest period = 0.120
Predicted sign	(B) $REV_{i,q}(q+1) \frac{REV_{i,q}(q+1)}{P_{i,t-2}} = \alpha_1 + \alpha_2 GDUM_{i,q} + \alpha_3 \frac{FE_{i,q}}{P_{i,t-2}} + \alpha_4 \frac{GDUM * FE_{i,q}}{P_{i,t-2}} + \eta_{i,q}^d$						F-value (sig. level)	Adj. R ²	N	Adj. R ² 's separate regressions
	α_1	α_2	+	α_3	?	α_4				
Value Line sample (55 contests)	-0.005 (-5.971)***	0.003 (0.767)	0.092 (6.725)***	+	0.210 (1.970)**	?	18.250 (0.0001)	0.050	979	Pre-contest = 0.044 Contest period = 0.297
Time-series sample	N/A									

^aGDUM = 1 if earnings announcement is for the last firm-quarter before the contested board election, = 0 if the earnings announcement occurs before the first public indication of dissident stockholder activity.

^bt-value in parentheses. Significance levels are for two-tailed tests unless sign of coefficient is predicted, then one-tailed.

*Significant at $\alpha = 0.10$.

**Significant at $\alpha = 0.05$.

***Significant at $\alpha = 0.01$.

^cThe time-series sample is comprised of 33 contests for which Value Line analysts' forecasts were not available. For these firms/contests, we forecast primary EPS before discontinued operations and extraordinary items using Foster's (1977) seasonal AR(1) model in first differences.

^dThe discrepancy between the number of observations in panels A and B is due to: (1) two observations where the VL edition was missing and, therefore, no revision could be computed; and (2) deletion of two observations in the pre-proxy period with extreme revisions (greater than \$8/sh.) that were associated with announced major restructurings. These latter two observations were more than 10 standard deviations from the mean and severely distorted the regression relation estimated in panel B.

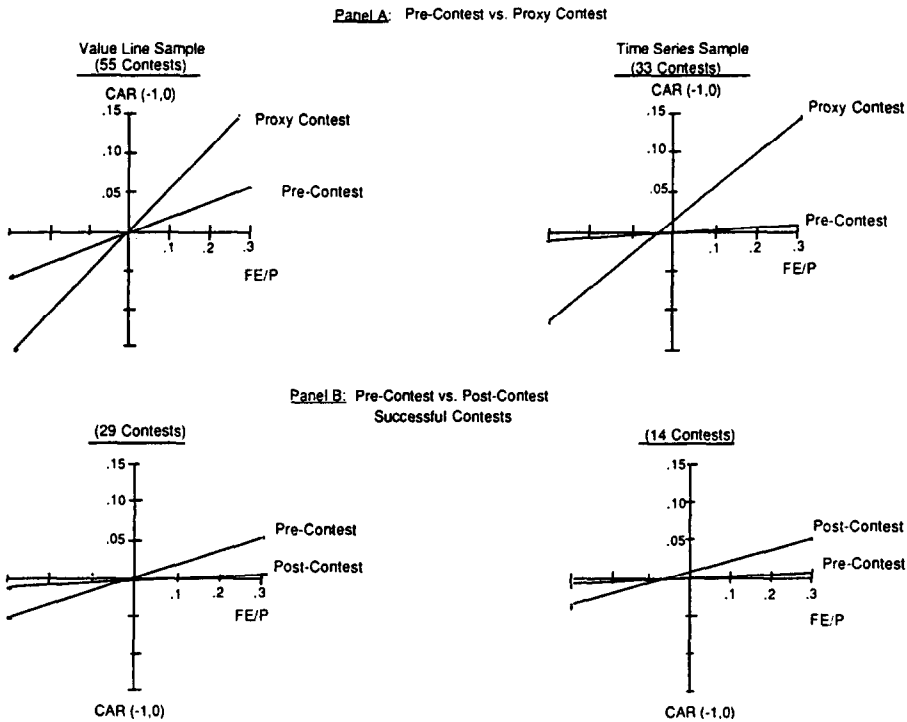


Fig. 1. Plots of earnings response coefficients; proxy contest vs. pre-contest (panel A), and pre-contest vs. post-contest period for successful contests (panel B).

reaction to earnings during the contest as in the pre-contest period. For the time-series sample, the adjusted R^2 over both periods is a much smaller 1.3%, consistent with our earlier discussion of the problems with time-series forecast errors. Once again, the explanatory power of the model improves dramatically (R^2 increases from 0.1% to 12%) during the proxy contest.

Panel B of table 2 reports results of tests for a differential revision in analysts' one-quarter-ahead forecasts in response to earnings surprises during the proxy contest. Again, these results are summarized graphically in panel A of fig. 2. These results exclude two outlier observations attributable to analysts' forecast revisions for company-announced writeoffs from restructurings.¹⁴ After deletion of these two outliers, the model has an adjusted

¹⁴The two outlier observations we deleted have $REV = -10.81$ and -8.15 and $REV/P = -2.6206$ and -2.7167 . These two observations were more than ten standard deviations from the mean and severely distorted the regression relation estimated in panel B of table 2. In both cases, analysts revised their earnings forecasts because of company announcements of major writeoffs due to restructurings. We discuss the problems posed by outliers in more detail in section 7 below.

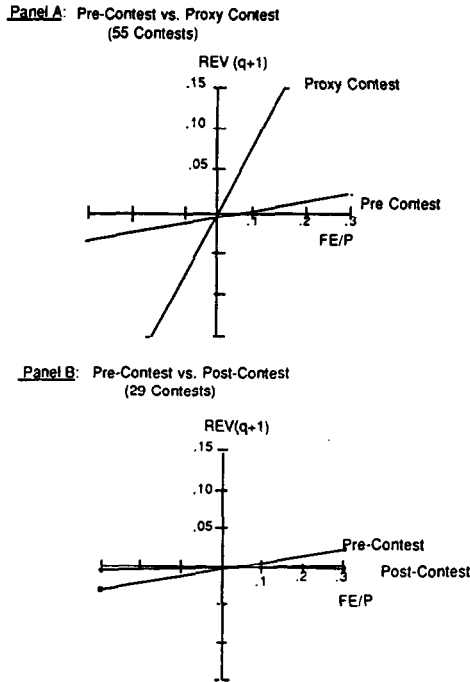


Fig. 2. Plots of analysts' earnings forecast revision coefficients; proxy contest vs. pre-contest (panel A), and pre-contest vs. post-contest period for successful contests (panel B).

$R^2 = 5\%$, and the difference in revision coefficients across the two periods ($\alpha_4 = 0.21$) is significant at the 0.05 level. Analysts' forecast revisions for a given earnings surprise during the proxy contest ($\alpha_3 + \alpha_4 = 0.092 + 0.210 = 0.302$) exceed by more than three times their pre-contest revisions ($\alpha_3 = 0.092$). Moreover, earnings surprises explain more than seven times the cross-sectional variation in analysts' forecast revisions during the contest as in the pre-contest period (adjusted $R^2 = 29.7\%$ versus 4.4% in the pre-contest period). In short, all results indicate that analysts revise their future forecasts more extensively after observing earnings released during the proxy contest than after observing the pre-contest earnings of the same firms.

Overall, the results presented in table 2 and panels A of figs. 1 and 2 indicate that earnings released during a proxy contest elicit a greater market reaction (and explain more than twice the cross-sectional variation in stock-price reaction) than do earnings released by the same firms in the pre-contest period. Moreover, analysts revise their future earnings forecasts to a greater-than-usual degree in response to earnings surprises during a proxy contest (which explain almost seven times the variation in analysts' revisions than

they do in the pre-contest period). Together, these results suggest that earnings released during a proxy contest are more informative than in prior periods, perhaps because their prominent role in the corporate governance process reflects their increased usefulness to investors attempting to evaluate managerial performance and/or to predict the contest outcome.¹⁵

5. Post-contest accruals, forecast errors, and analysts' revisions

Of the 88 proxy contests in our sample, 43 were successful in that (i) dissidents acquired at least a majority of the board seats, and/or (ii) the contest was followed within three years (two years for 1987 contests) by a change in CEO, Board Chairman, and/or President. Table 3 reports post-contest unexpected accruals, analysts' forecast errors, analysts' forecast revisions, and Foster time-series model forecast errors for the sample partitioned by whether or not the proxy contest was successful in this broader sense. The panel A unexpected accruals are calculated using a random-walk model for the first annual earnings after the contest outcome (or management change, hereafter the contest outcome). The panels B, C, and D forecast errors and analysts' revisions are for the first four quarters after the contest outcome.

The panel A unexpected accruals indicate that new management tends to take an earnings 'bath' after a successful proxy contest, both relative to the firm's prior accruals and to the accruals of firms with unsuccessful proxy contests.¹⁶ For the 37 successful contests with complete post-contest data, mean (median) unexpected accruals are -2.78% (-3.29%) of total assets, and are negative at the 0.0265 (0.0167) level. These figures are less dramatic than those for successful contests in DeAngelo (1988a), but are nonetheless quite strong. For the 38 unsuccessful contests, mean and median unexpected accruals are insignificantly different from zero although, as is the case for the successful contests, the proportion of negative accruals is significantly greater than 50%. Finally, mean (median) post-contest unexpected accruals are more negative for firms with successful than with unsuccessful proxy contests, at the 0.0169 (0.0300) level, although the proportion of negative accruals does not differ across groups.¹⁷

¹⁵One possibility is that the pre-contest period is one in which earnings are an especially noisy indicator of managerial performance. In fact, 'low' earnings informativeness in the pre-period may reflect factors that lead to the proxy contest, e.g., asset writedowns and restructuring costs. However, our inference that the *relative* informativeness of earnings is greater during the contest is unchanged even if pre-contest earnings are quite noisy. For some empirical evidence on this issue, see the sensitivity checks in section 7 below.

¹⁶Managers of firms with unsuccessful proxy contests do not have the same incentives to take an earnings 'bath' as new managers of firms with successful contests because their jobs likely remain in jeopardy for some period after the contest.

¹⁷These results are for the random-walk model. Results under the alternative model are less strong, with respective significance levels of 0.0512 and 0.1364 for the *t*-test and Wilcoxon test.

Table 3

Unexpected accruals, earnings forecast errors, and analyst revisions after a proxy contest: 88 proxy contests for board seats on 83 listed corporations (1970–1987).

	Mean (<i>p</i> -value) ^e	Deciles ^c					%pos./%neg. (<i>p</i> -value) ^e
		1	3	5	7	9	
<i>(A) Unexpected accruals (random-walk model)^a</i>							
Successful contests (37 contests)	-0.0278 (0.0265) ^b	-0.1188	-0.0619	-0.0329 (0.0167) ^b	-0.0010	0.0899	27:73 (0.0010) ^b
Unsuccessful contests (38 contests)	0.0282 (0.2030)	-0.0670	-0.0400	-0.0088 (0.8109)	0.0251	0.2030	37:63 (0.0262)
<i>P</i> -value for difference	(0.0169) ^b			(0.0300) ^b			(0.1763) ^b
<i>(B) Analysts' earnings forecast errors^c (55 contests)</i>							
Successful contests (97 quarters)	-0.0531	-0.1010	-0.0304	-0.0036	0.0029	0.0113	40:60
Unsuccessful contests (89 quarters)	-0.0147	-0.0359	-0.0047	0.0000	0.0034	0.0116	46:48
<i>P</i> -value for difference	(0.0640)			(0.0216)			(0.1170)
<i>(C) Analysts' forecast revisions^d (55 contests)</i>							
Successful contests (96 quarters)	-0.0107	-0.0303	-0.0078	0.0000	0.0000	0.0070	26:44
Unsuccessful contests (87 quarters)	-0.0075	-0.0229	-0.0036	0.0000	0.0000	0.0061	30:40
<i>P</i> -value for difference	(0.2963)			(0.1903)			(0.2709)
<i>(D) Foster time-series model forecast errors^f (33 contests)</i>							
Successful contests (42 quarters)	0.0034	-0.1102	-0.0152	0.0014	0.0148	0.0555	52:48
Unsuccessful contests (60 quarters)	0.0060	-0.0163	-0.0021	0.0030	0.0083	0.0291	68:32
<i>P</i> -value for difference	(0.4160)			(0.2063)			(0.0516)

^aData are for the 75 proxy contests with complete data available for the first annual earnings release after the contest outcome (management change). Thirty-seven of these contests are successful in that (i) dissidents won at least a majority of the board seats, and/or (ii) the contest was followed within three years (two years for 1987 contests) by a change in CEO, President, and/or Chairman. Unexpected accruals are standardized by total assets.

^b*P*-values are one-tailed, to test the hypothesis that new managers take an earnings 'bath' after a proxy-contest-induced management change. Results are virtually identical under the alternative model, which employs the difference between net income and working capital from operations in the comparison period as a benchmark for 'normal' accruals, except that the difference in means (medians) across the two subsamples is only significant at the 0.0512 (0.1364) level.

^cData are for the 55 proxy contests for which Value Line earnings forecasts are available in the four quarters after the contest outcome. Earnings forecast errors are calculated as (actual - expected), and are scaled by stock price two days before the earnings announcement.

^dData are for the 55 proxy contests for which Value Line earnings forecasts are available in the four quarters after the contest outcome. Analysts' forecast revisions are the difference between the one-quarter-ahead earnings forecast after release of current earnings and the same forecast before release of current earnings, scaled by stock price two days before the current-earnings announcement.

^e*P*-values are one-tailed, to test for a significant difference in the indicated variable across the successful and unsuccessful subsamples, or to test for differences in proportions of %pos. (neg.).

^fThe predicted earnings figure is primary *EPS* before discontinued operations and extraordinary items. Earnings forecast errors are calculated as (actual - predicted), and are scaled by stock price two days before the earnings announcement.

The panel B data reveal that analysts' forecasts do not fully anticipate the extent to which post-contest earnings are understated, and this is more likely the case for firms with successful proxy contests. The mean (median) forecast error for successful contests is -5.31% (-0.36%) versus -1.47% (0.00%) for unsuccessful contests. The difference in means is significant at the 0.0640 level under a one-tailed test, while the difference in medians is significant at the 0.0216 level. For successful contests, 60% of the forecast errors are negative, while 48% are negative in unsuccessful contests, with the difference in proportions significant at the 0.1170 level (one-tailed). Thus, most of the panel B results indicate that analysts' post-contest forecast errors are systematically more negative for firms previously engaged in successful than in unsuccessful proxy contests.

Although not shown in table 3, post-contest analysts' forecast errors are significantly more negative than are pre-contest forecast errors for firms with successful proxy contests. In the pre-contest period, the mean (median) analysts' forecast error is -1.41% (-0.16%), and 55.8% of the pre-contest forecast errors are negative. The mean (median) post-contest forecast error is lower than its pre-contest counterpart at the 0.0478 (0.0273) level. The proportion of negative forecast errors is greater in the post-contest than in the pre-contest period at the 0.1635 significance level. In short, most of our tests indicate that analysts' forecast errors are significantly more negative after a successful proxy contest than (i) they are in the pre-contest period for the same sample firms, and (ii) they are in the post-contest period for firms whose proxy contests are unsuccessful.¹⁸

This finding is somewhat surprising, since it indicates that analysts do not systematically anticipate the negative post-contest earnings of firms with successful proxy contests, despite knowledge of the contest outcome. One possible explanation is that analysts are uncertain about the exact timing of noncash writeoffs, gains/losses from asset dispositions, and the other costs of restructuring efforts, as well as their potential magnitude. To assess the reasonableness of this conjecture, we examined post-contest annual reports for the 37 successful proxy contests for unusual income items (both positive and negative, cash and noncash) that would make forecasting post-contest earnings especially difficult. The appendix reports a verbal description of the results of this investigation, while table 4 describes summary statistics on unusual items (in total and by various categories) as a percent of the absolute value of net income.¹⁹

¹⁸The panel D time-series forecast errors also tend to be more negative for successful contests, although the results are not strong. The mean, median, and proportion of positive forecast errors are all in the direction predicted for successful versus unsuccessful contests, but only the last difference is significant at close to conventional levels (at the 0.0516 level).

¹⁹DeAngelo (1988a, table 10) has previously shown that the incidence of unusual income items for firms with a successful proxy contest is greater than that for firms in Accounting Trends

Table 4

Incidence and magnitude of unusual income items after a successful proxy contest: 37 firms that experienced a proxy-contest-induced management change.^a

Unusual income item	Number (%) of firms reporting item	Mean percent of net income ^c	Deciles ^c				
			1	3	5	7	9
Loss provisions, writeoffs, and restructuring costs	25 (67.6%)	-143.6%	-553.1%	-128.6%	-100.1%	-46.1%	-6.8%
Gains or losses on asset sales and settled litigation	20 (54.1)	32.2	-83.1	-21.3	4.9	54.6	122.3
Costs of proxy contest and severance pay	22 (59.5)	-66.5	-185.0	-63.9	-51.5	-27.8	-6.8
Accounting changes	6 (16.2)	204.0	-1.5	7.2	19.0	25.1	1148.6
Tax-loss carry-forwards	7 (18.9)	48.7	0.4	28.8	46.0	47.9	91.8
Other ^b	3 (8.1)	186.5	-19.4	N/A	10.6	N/A	568.4
Total unusual items	35 (94.6%)	-65.3%	-314.7%	-134.6%	-96.2%	-43.1%	106.8%

^aData are for the 37 proxy contests that are successful in that (i) dissidents won at least a majority of the board seats, and/or (ii) the contest was followed with three years (two years for 1987 contests) by a change in CEO, President, and/or Chairman.

^b'Other' includes gain or loss on pension terminations and interest penalty on federal tax amounts.

^cMean and decile values are expressed as a percent of the absolute value of net income. They are calculated using the number of firms reporting a given unusual item, e.g., for the 25 firms with loss provisions, we divide by 25, and not by 37 (the total number of successful proxy contests).

The appendix reveals that the vast majority (35 of 37, or 95%) of firms report unusual income items following a successful proxy contest.²⁰ Of the 35 firms that report unusual income items, 28 firms (80%) report unusual items that are negative in the aggregate. For example, GAF Corporation, whose management lost the election, had -\$14.3 million in unusual items the first year under new management, and reported a \$3.8 million loss. Moreover, unusual items would have totalled -\$36.1 million had new management been able to avoid a \$21.8 million gain from a pension termination that

and Techniques over the same periods. Moreover, to the extent that unexpected accruals incorporate the effects of unusual income items, our table 3 results indicate that the number of these items is greater for firms with a successful proxy contest than for (i) the same firms in earlier periods and (ii) firms whose proxy contests were unsuccessful.

²⁰Other empirical studies of asset writeoffs and other unusual income items include Strong and Meyer (1987), Elliott and Shaw (1988), and DeAngelo, DeAngelo, and Skinner (1990).

former management had initiated during the proxy contest (and that had just received governmental approval).

The summary statistics in table 4 reinforce the overall impression one gains from a reading of the appendix. On average, total unusual items comprise a negative 65.3% of reported income (median, -96.2%) after a successful proxy contest. The predominant type of unusual item is a noncash writeoff or loss provision that does not result from an actual transaction with an outside party, with 25 firms (67.6% of firms with successful contests) taking such provisions. The average loss provision represents -143.6% of reported income (median, -100.1%) for firms that took such provisions after a successful proxy contest. Interestingly, the costs of waging a proxy contest are nontrivial, comprising some -66.5% of net income on average (median, -51.5%) for firms that reported these costs. Given the nature, number, variety, sign, and magnitude of the unusual income items documented in the appendix and summarized in table 4, it seems considerably less surprising that analysts' forecasts are overly optimistic after a successful proxy contest.

This conclusion is reinforced by the data on analysts' one-quarter-ahead forecast revisions reported in panel C of table 3. These data reveal no detectable difference in means, medians, or percent of negative analysts' forecast revisions across the successful and unsuccessful contests. Thus, despite the fact that earnings surprises tend to be significantly more negative after successful than after unsuccessful contests, analysts do not revise their next-quarter forecasts more in response. Together with our evidence of negative unexpected accruals and unusual income items, these results suggest that analysts perceive the post-contest earnings of firms with successful proxy contests as largely reflecting negative transitory adjustments, such as one-time writeoffs taken by new management, rather than as reflecting permanent changes in firm profitability under new management.

6. Market and analyst reactions to earnings after successful proxy contests

Our evidence that new management tends to take an earnings 'bath' after a successful proxy contest suggests that market and analyst reactions are likely dampened in the post-contest, relative to the pre-contest period. We once again use eqs. (2) and (3) to test for differential *ERC*'s and analysts' forecast revisions after a successful proxy contest. The test results are presented in table 5 and the plots of *ERC*'s and revision coefficients are presented in panels B of figs. 1 and 2. Panel A of table 5 reveals that the post-contest *ERC* is less than one-fifth as large as the pre-contest *ERC* ($\hat{\gamma}_3 + \hat{\gamma}_4 = 0.034$ versus $\hat{\gamma}_3 = 0.184$, difference significant at the 0.01 level). Moreover, the adjusted R^2 after a successful proxy contest (1.7%) is one-third the adjusted R^2 in the pre-contest period (4.7%). This evidence suggests that

Table 5

Summary regression results for differential ERC's and revision coefficients for pre-contest vs. post-contest period for 43 firms that experienced a proxy-contest-induced management change.

Predicted sign	(A) $CAR(-1, 0)_{it} = \gamma_1 + \gamma_2 GDU_{it} + \gamma_3 \frac{FE_{it}}{P_{it-2}} + \gamma_4 \frac{GDUM * FE_{it}}{P_{it-2}} + \epsilon_{it}$ ^a						F-value (sig. level)	Adj. R ²	N	F-value (sig. level)	Adj. R ² 's separate regressions
	γ_1	γ_2	γ_3	γ_4	?	?					
Value Line sample (29 contests)	-0.002 (-1.223) ^b	-0.002 (-0.318)	0.184 (6.916) ^{***}	-0.150 (-4.239) ^{***}	?	?	16.690 (0.0001)	0.044	1023	16.690 (0.0001)	Pre-contest = 0.047 Post-contest = 0.017
Time-series sample ^c (14 contests)	-0.001 (-0.230)	0.007 (0.654)	0.039 (1.221)	0.112 (0.980)	?	?	1.295 (0.2745)	0.002	506	1.295 (0.2745)	Pre-contest = 0.001 Post-contest = 0.023
	(B) $REV_{it}(q+1) = \alpha_1 + \alpha_2 GDU_{it} + \alpha_3 \frac{FE_{it}}{P_{it-2}} + \alpha_4 \frac{GDUM * FE_{it}}{P_{it-2}} + \eta_{it}$ ^d										
Predicted sign	α_1	α_2	α_3	α_4	?	?	F-value (sig. level)	Adj. R ²	N	F-value (sig. level)	Adj. R ² 's separate regressions
Value Line sample (29 contests)	-0.005 (-5.986) ^{***}	-0.001 (-0.339)	0.092 (6.743) ^{***}	-0.086 (-4.803) ^{***}	?	?	15.218 (0.0001)	0.040	1019	15.218 (0.0001)	Pre-contest = 0.044 Post-contest = -0.007
Time-series sample	N/A										

^a $GDUM = 1$ if earnings announcement is in the four quarters following a successful proxy contest, = 0 if the earnings announcement occurs before the first public indication of dissident stockholder activity.

^b t -value in parentheses. Significance levels are for two-tailed tests unless sign of coefficient is predicted, then one-tailed.

^c Significant at $\alpha = 0.10$.

^d Significant at $\alpha = 0.05$.

^e Significant at $\alpha = 0.01$.

^f The time-series sample is comprised of 14 contests for which Value Line analysts' forecasts were not available. For these firms/contests, we forecast primary EPS before discontinued operations and extraordinary items using Foster's (1977) seasonal AR(1) model in first differences.

^g The discrepancy between the number of observations in panels A and B is due to: (1) two observations where the VL edition was missing and, therefore, no revision could be computed; and (2) deletion of two observations in the pre-proxy period with extreme revisions (greater than \$8/sh.) that were associated with announced major restructurings. These latter two observations were more than 10 standard deviations from the mean and severely distorted the regression relation estimated in panel B.

earnings released after a successful proxy contest are less informative than pre-contest earnings, perhaps due to the earnings 'baths' taken by new management.²¹

The results of pre- and post-contest comparisons for the time-series sample are somewhat anomalous. First, the post-contest *ERC* of 0.151 represents an increase over the pre-contest *ERC* of 0.039, but the difference is not significant. This result is not too surprising, given the pre-contest *ERC* is not significantly different from zero for the time-series sample. The adjusted R^2 in the post-contest period also increases from that in the pre-contest period (from 0.001 to 0.023). The regression model, however, is insignificant, with F -value = 1.295 and significance level of 0.2745. Basically, the post-contest results for the time-series sample suggest that unexpected earnings explain little or no variation in stock returns around earnings announcements. We attribute these results to the measurement error in forecast errors from using a time-series model to generate unexpected earnings, to the garbling in post-contest earnings caused by unusual income items, and to the small sample size (14 contests in the post-contest period).

Panel B of table 5 and fig. 2 report results of tests for a differential analyst forecast revision in response to earnings released after a successful proxy contest, relative to the pre-contest period. These results indicate that post-contest earnings surprises have a lower impact on analysts' future earnings expectations than do pre-contest earnings surprises, holding the magnitude of the surprise constant.²² The average revision coefficient (per unit of unexpected earnings) is 0.006 (0.092 – 0.086) in the four quarters following the contest outcome, compared to 0.092 in the pre-contest period. The difference is significant at the 0.01 level. Moreover, the adjusted R^2 for a separate regression in the post-contest period is –0.7%, compared to 4.4% in the pre-contest period.

Overall, then, we find reasonably consistent evidence that market and analyst reactions to earnings released after a proxy-contest-induced change in managerial control are dampened relative to their reactions in periods before the proxy contest. Our evidence on unexpected accruals and unusual income items suggests that this dampened response likely reflects the increased noise in post-contest earnings due to one-time earnings 'baths' taken by new management.

²¹The comparisons in table 5 use all observations for the pre-contest period, including those for firms with unsuccessful contests, in order to increase the power of the tests. We obtain similar results when we use pre-contest observations only for firms with successful proxy contests. For the VL sample, the γ_4 estimate in panel A is –0.157, with a t -statistic of –4.006, and the α_4 estimate in panel B is –0.098, with a t -statistic of –4.617. For the time-series sample, the γ_4 estimate in panel A is 0.132, with a t -statistic of 1.418.

²²The regression results in panel B of table 5 are after deletion of two outlier observations that were associated with announced major restructurings. See fn. 14 for details.

7. Sensitivity checks and methodological issues

Our sample consists of firms whose prior performance was sufficiently poor that dissident stockholders chose to wage an expensive proxy contest for board representation.²³ It is therefore reasonable to expect that asset write-offs and losses from corporate restructurings are not an uncommon occurrence before (as well as after) the contest. Such unusual income items can dramatically affect the estimated coefficients and goodness-of-fit measures in eqs. (2) and (3).²⁴ The estimated pre-contest *ERC* for the VL sample (0.184 from table 2) is considerably smaller than that in other 'short window' studies that use VL forecasts as a proxy for market earnings expectations. For example, Brown et al. (1987, table 2) report an *ERC* of 0.70 when regressing two-day (-1, 0) abnormal returns around quarterly earnings announcements on VL forecast errors scaled by stock price at $t - 2$. The discrepancy between our and others' *ERC* estimates (and the unique characteristics of our sample) suggests that our table 2 results might be heavily influenced by outlier observations that are best deleted from the analysis.

On the other hand, there is the clear danger of 'throwing the baby out with the bathwater' in an attempt to control for 'outlier' observations that are really admissible data points in a particular decision context [Foster (1986, pp. 100-101) provides an excellent discussion of this issue]. One plausible scenario in the current context is that firms whose managers subsequently face a proxy contest are troubled companies that naturally have a number of negative unusual income items before a control battle materializes. In this view, negative income items reflect the factors that helped *induce* the proxy contest, e.g., asset values are lower than previously reported because of incumbent management's abnormally low performance. Thus, low pre-contest *ERC*'s can reflect managerial problems that bring on a proxy contest, so that these observations are not appropriately treated as 'outliers'.

Despite the difficulties of determining what constitutes an outlier in a given context, it is instructive to determine the extent to which our results

²³DeAngelo (1988a) finds that firms whose managers face a proxy contest had below-market accounting performance in the pre-contest period. The appendix contains numerous examples which suggest that the costs of waging a proxy contest are of economically significant magnitude. For example, Canal-Randolph Corp. had \$2.4 million in such costs in a year in which net income was \$1.8 million. See also the summary statistics in table 4.

²⁴For example, General Refractories announced late in 1982 that it would take a \$37 million charge for the estimated costs of plant shutdowns, asset disposals, and other related expenses. As a result, VL analysts revised their estimate of 4Q-1982 earnings from \$ - 0.62/sh. to \$ - 11.43/sh., a 1843% decrease! This revision is obviously not explained by the earnings forecast error of \$ - 0.89 for the previous quarter as suggested by the regression specification in eq. (3). Similarly, distortions in the return/unexpected earnings relation in eq. (2) can occur when actual results include the effects of unusual items not reflected in analysts' forecasts, but known to the market when earnings are released. For example, Crown Zellerbach's 4Q-1982 earnings release attributed most of its reported loss of \$ - 5.55/sh. to the sale of Crown Zellerbach Canada Ltd. (the VL forecast was \$0.20/sh.).

depend on *potential* outlier observations. Hence, we re-estimate eqs. (2) and (3) for the proxy-contest versus pre-contest comparisons, after excluding extreme observations that could be specifically attributed to nonrecurring income items.²⁵ We (arbitrarily) define extreme *FE* and *REV* values as $|FE's| \geq \$1.00$ and $|REV's| \geq \$0.50$. Forty-five observations from the VL sample (23 from the time-series sample) exceed the *FE* threshold (between 4 to 5% of the total observations in the combined pre-contest and contest periods). Additionally, 64 observations exceed the *REV* threshold (approximately 6.5%) in the combined periods. We then determine from *WSJ* and VL reports if (i) earnings include nonrecurring items that were public knowledge at announcement, and if (ii) VL mentions any such items as the reason for the forecast revision for the upcoming quarter.

The reduced-sample tests of eq. (2) omit the 30 extreme VL forecast errors (five extreme time-series forecast errors) for which the *WSJ* specifically mentions nonrecurring income items. These deletions represent 3.0% and 0.9% of the total-sample observations, respectively. The vast majority (84%) of the deleted VL forecast errors are negative, while 60% of the deletions in the time-series sample are negative. For the VL and time-series samples, only one forecast error is deleted from each sample during the proxy contest itself. Interestingly, in both cases the observations are positive.²⁶

The reduced-sample tests of eq. (3) omit 16 (25%) of the 64 extreme *REV's*, which VL specifically attributes to nonrecurring income items.²⁷ Again, the vast majority (75%) of the deleted observations are negative. Only one extreme analysts' revision occurs during the proxy contest and it, once more, is positive.²⁸ The absence of extreme forecast errors and analysts' forecast revisions due to unusual income items during the proxy contest stands in marked contrast to the prevalence of these items in the pre- and post-contest periods. These facts suggest that managers are reluctant to take special charges to earnings during a proxy challenge, consistent with our earlier evidence of earnings management.

²⁵We do not re-estimate eqs. (2) and (3) for the post-contest versus pre-contest comparisons, since post-contest earnings 'baths' by nature include unusual income items and excluding such items from the pre-contest period would only strengthen the results in table 5.

²⁶From the VL sample, Vornado's 4Q-1978 earnings of \$1.89/sh. announced just prior to the contested board election includes a pre-tax gain of approximately \$1.65/sh. from the sale of various operating assets. From the time-series sample, Chicago Rivet and Machine reported a 1Q-1981 gain of \$1.41/sh. from a building sale as part of its reported earnings of \$1.69/sh.

²⁷The 30 extreme VL forecast errors attributed to nonrecurring income items noted above were also deleted for our reduced sample tests of eq. (3). In eight cases an observation was deleted because of both an extreme *FE* and an extreme *REV* caused by nonrecurring items.

²⁸Value Line revised its 2Q-1982 earnings forecast for Tosco Corp. from \$0.60/sh. to \$4.70/sh. due to Tosco's announced sale of its interest in Colony Corp. to Exxon, which was estimated to boost Tosco's earnings by \$4.35/sh.

Table 6

Summary regression results for differential *ERC*'s and revision coefficients for pre-contest vs. proxy-contest period: 88 proxy contests for board seats on listed firms (1970-1987). Outliers due to special items are deleted.

Predicted sign	(A) $CAR(-1, 0)_{i,q} = \gamma_1 + \gamma_2 G D U M_{i,q} + \gamma_3 \frac{F E_{i,q}}{P_{i,t-2}} + \gamma_4 \frac{G D U M * F E_{i,q}}{P_{i,t-2}} + \epsilon_{i,q}$							Adj. R^2 's separate regressions
	γ_1	γ_2	γ_3	γ_4	N	Adj. R^2	F-value (sig. level)	
VL sample (55 contests) with deletion of extreme <i>FE</i> 's ^b	-0.002 (-1.009) ^c	0.008 (0.090)	0.383 (7.404) ^{***}	0.234 (1.053)	953	0.061	21.497 (0.0001)	Pre-contest = 0.056 Contest period = 0.125
Time-series sample (33 contests) ^d with deletion of extreme <i>FE</i> 's	-0.000 (-0.020)	0.0189 (1.607)	0.088 (2.121) ^{***}	0.345 (1.443)	494	0.018	4.010 (0.0079)	Pre-contest = 0.007 Contest period = 0.087
Predicted sign	(B) $REV_{i,q}(q+1) = \alpha_1 + \alpha_2 G D U M_{i,q} + \alpha_3 \frac{F E_{i,q}}{P_{i,t-2}} + \alpha_4 \frac{G D U M * F E_{i,q}}{P_{i,t-2}} + \eta_{i,q}$							Adj. R^2 's separate regressions
	α_1	α_2	α_3	α_4	N	Adj. R^2	F-value (sig. level)	
VL sample (55 contests) with deletion of extreme <i>REV</i> 's and <i>FE</i> 's	-0.004 (-5.852) ^{***}	0.002 (0.638)	0.158 (7.428) ^{**}	0.156 (1.677) [*]	941	0.065	22.649 (0.0001)	Pre-contest = 0.056 Contest period = 0.284
Time-series sample (33 contests) with deletion of extreme <i>REV</i> 's and <i>FE</i> 's	N/A							

^a *GDUM* = 1 if earnings announcement is for the last firm-quarter before the contested board election, = 0 if the earnings announcement occurs before the first public indication of dissident stockholder activity.

^b Extreme *FE*'s = $|FE| \geq \$1.00$ attributable to special one-time items; extreme *REV*'s = $|REV| \geq \$0.50$ attributable to special one-time items.

^c *t*-value in parentheses. Significance levels are for two-tailed tests unless sign of coefficient is predicted, then one-tailed.

^{*} Significant at $\alpha = 0.10$.

^{**} Significant at $\alpha = 0.05$.

^{***} Significant at $\alpha = 0.01$.

^d The time-series sample is comprised of 33 contests for which Value Line analysts' forecasts were not available. For these firms/contests, we forecast primary *EPS* before discontinued operations and extraordinary items using Foster's (1977) seasonal AR(1) model in first differences.

Table 6 reports results of tests for a differential market and analyst reaction to earnings released during the proxy contest, after deletion of extreme observations identified via the above procedure. Panel A indicates that pre-contest *ERC*'s ($\hat{\gamma}_3$) more than double (to 0.383 for the VL and 0.088 for the time-series sample) from their estimates in the full sample (0.184 for the VL and 0.039 for the time-series sample in table 2). Although the differential *ERC*'s during the proxy contest ($\hat{\gamma}_4$) remain positive (0.234 for the VL and 0.345 for the time-series sample), they are no longer statistically significant. As one might expect, the adjusted R^2 for the reduced sample is slightly higher than for the full sample (6.1% for the VL and 1.8% for the time-series sample). The adjusted R^2 for the VL (time-series) reduced sample is 5.6% (0.7%) in the pre-contest period versus 12.5% (8.7%) during the contest. Again, these results indicate that earnings surprises explain considerably more of the cross-sectional variation in the stock-price reaction to earnings released during the proxy contest than they do in the pre-contest period.

The reduced-sample results in panel B of table 6 continue to show that analysts revise their future forecasts to a greater-than-usual degree after observing earnings released during the proxy contest. The α_4 coefficient is 0.156, and is positive at the 0.10 level. Moreover, the adjusted R^2 during the proxy contest is over five times larger than in the pre-contest period (0.284 versus 0.056). These results, albeit weaker, are similar to those reported in table 2 for the full sample. In short, all results (with and without deletions of extreme observations) suggest that market and analyst reactions to earnings announced during a proxy contest are more pronounced than in periods before the proxy contest.

8. Summary and conclusions

Over the past twenty years, an extensive empirical literature has developed that attempts to assess the information content of reported earnings. Paralleling the development of this literature is the emergence of a separate line of inquiry into issues of earnings management and income smoothing. Despite claims that earnings management reduces the informativeness or 'quality' of reported earnings, there has been little or no empirical work that directly tests the relative information content of managed earnings. The present study represents an initial attempt to assess the information content of earnings in a particular decision context – that of a proxy contest whose objective is to remove allegedly incompetent management. It therefore represents an initial attempt to bridge the gap between the previously distinct information content and earnings management literatures.

Despite indications of earnings management during the election campaign, market and analyst reactions to earnings of firms engaged in proxy contests

are more pronounced than they are in prior periods. Moreover, earnings surprises explain more than twice the cross-sectional variation in the stock-price reaction, and almost seven times the variation in analyst reaction, to earnings released during the contest as in the pre-contest period. These results suggest that earnings released during a proxy contest are more informative than the pre-contest earnings of the same firms. We interpret these results as indicating that the prominent role of reported earnings in the corporate governance process reflects their increased usefulness to investors attempting to evaluate managerial performance and/or to predict the contest outcome.

If the proxy contest results in a top management change, new management tends to take an earnings 'bath'. The post-contest earnings of firms whose proxy contests are successful are met with a dampened market and analyst reaction relative to that in prior periods. Moreover, post-contest earnings surprises explain only one third the cross-sectional variation in the stock-price reaction, and essentially none of the analyst reaction, to earnings released after a proxy-contest-induced change in managerial control. These results suggest that the earnings 'baths' typically taken by new management render post-contest earnings less informative than pre-contest earnings for firms with successful proxy contests.

In the course of our investigation, we encountered several difficulties that will likely also affect future studies of the information content of managed earnings. First, settings that provide incentives for earnings management are likely those characterized by heightened investor uncertainty about the cash-flow prospects of the firm – and reported earnings can be especially useful in resolving such uncertainty. If the uncertainty-resolution effects of earnings dominate any garbling induced by earnings management, managed earnings will be met with a *greater*-than-usual market and analyst reaction. As a result, researchers must carefully analyze the particular context in which earnings management is predicted to occur to anticipate *all* potential effects on market and analyst behavior, rather than naively predict that managed earnings are less informative than the 'normal' earnings of a given firm.

Second, the nonrandom samples in which one expects earnings management also likely exhibit extreme analysts' forecast errors, forecast revisions, and/or stock returns. Such 'outliers' can affect the determination of a normal market or analyst reaction to earnings, yet deleting them may be unwarranted, given the specific context in which they occur. Third, the 'best' empirical proxy for expected earnings is unclear for studies that attempt to assess the information content of managed earnings. One problem with analysts' forecasts is that analysts might anticipate managers' accounting choices and adjust their forecasts accordingly, thereby largely removing the effects of earnings management. The problems with time-series models include: 1) distortions in forecasts for the current quarter if the year-earlier quarterly earnings included nonrecurring gains or losses, 2) large standard

errors on parameter estimates because of limited time-series data, and 3) parameter instability over time. All these factors introduce measurement error in the proxy for unexpected earnings which, in turn, induces a downward bias in *ERC* estimates and R^2 values.

In sum, ours is the first study to test for a differential market and analyst reaction to managed earnings. The empirical problems we encounter can be expected to affect future studies of the information content of earnings that serve a particular function – e.g., are used in governmental investigations of the profitability of certain industries, rate regulation, union negotiations, equity valuation in corporate restructurings, etc. – and therefore are predicted to be managed in a particular direction. Beyond our specific findings for firms engaged in proxy contests, our general approach and the methodological refinements we develop to address the empirical difficulties we encounter may be useful to future researchers attempting to assess the quality or informativeness of earnings in a variety of different decision contexts.

Appendix

This appendix provides a brief description of unusual income items in the first year after a successful proxy contest. Unusual income items include special or nonrecurring revenues/charges, gains/losses from asset sales, extraordinary items, and discontinued operations, and the effects of accounting changes. They are obtained from a reading of the relevant financial statements, notes thereto, management's letter to stockholders, and management's discussion and analysis. Extraordinary items, discontinued operations, and effects of accounting changes are net of income taxes, while all other amounts are pre-tax. Each entry lists the firm name, the date of the first post-contest annual report, the amount of total unusual items and net income (in \$000s). It is followed by a brief description of the contest outcome and a breakdown of the unusual items into major categories and amounts. (Note: Six of the 43 firms that experienced a management change following a proxy fight either merged or were acquired before financial statements were issued in the year after a successful proxy contest. The analysis here covers the remaining 37 successful contests.)

A.J. Industries, Inc. (3/31/71) Total unusual items, -1,139; net income, -2,645.

Dissidents elected 2 of the 7 directors, and the Chairman resigned. Unusual income items consist of -366 loss on disposition and abandonment of property; -425 (net of tax) loss on attempted disposition of a division accounted for as an extraordinary item; and -348 (net of tax) severance pay, also accounted for as an extraordinary item.

Alexander's (7/25/81) Total unusual items, -8,354; net income, -9,568.

Dissidents acquired effective control of the board via a settlement that included the Chairman's resignation. Unusual income items consist entirely of -8,354 loss on the sale of a subsidiary.

American Bakeries Company (1/1/83) Total unusual items, -12,855; net income, -10,916.

Dissidents initially won 4 of 12 seats on the staggered board. They eventually acquired control and their leader replaced the Chairman and President, who resigned. Unusual income items consist of -10,250 in anticipated costs of plant shutdowns; -3,220 in anticipated costs of two currently pending lawsuits; 515 gain from reversal of prior losses on discontinued operations; and 100 gain from reversal of prior provisions for proxy-contest expenses, treated as an extraordinary item.

Bradford National Corporation (12/31/83) Total unusual items, -8,958; net income, -8,088.

The dissidents acquired 5 of 9 seats in a settlement with management, and their leader was named CEO. The 4 management directors ultimately resigned. Unusual income items consist of -2,844 loss on disposition of product line; -3,119 provisions for transactional losses and asset writedowns on equity-clearing operations of subsidiary; -2,021 proxy-contest expenses, including -500 settlement of contractual obligation to a former officer; -225 severance pay to that officer; -678 loss on dispositions of affiliate; and -71 loss on discontinued operations.

Campbell Resources Inc. (6/30/80) Total unusual items, 5,349; net income, 9,462.

The dissidents elected all 9 directors and replaced the CEO and the Chairman. Unusual income items consist of -440 for proxy-contest expenses; 5,931 gain on sale of investment; and -142 effect of a change in accounting for deferred mining development costs.

Canal-Randolph Corporation (10/31/83) Total unusual items, -2,430; net income, 1,805.

The dissidents initially settled for 3 of 6 board seats. Ultimately the CEO was replaced by the dissident leader, Asher Edelman, who eventually liquidated the company. Unusual income items consist entirely of proxy-contest expenses.

Canoga Industries (10 / 31 / 71) Total unusual items, -367; net income, -291.

The dissidents elected 3 of 7 directors and replaced the CEO. Unusual income items consist of -255 loss on discontinued operations; -62 for settled litigation; and -50 expenses of the proxy contest.

Chicago Rivet & Machine Company (12 / 31 / 81) Total unusual items, 651; net income, 1,672.

The President/CEO resigned before the contest was settled. The dissidents ultimately sold their shares to the firm at a premium. Unusual income items consist of 1,229 gain on the sale of a building; -290 loss on sale of Mexican affiliates (to avoid a writeoff due to devaluation of the Mexican peso); -109 expenses of the proxy contest; -179 severance pay to a former officer.

Citadel Holding Corporation (12 / 31 / 85) Total unusual items, -12,769; net income, 26,044.

The dissidents acquired 3 of 10 board seats via a settlement, and the CEO/Chairman resigned 2 months later. Unusual income items consist of -7,692 writedown of a loan; -3,077 legal and other expenses related to the proxy contest; and -2,000 writedown of real estate.

CLC of America, Inc. (12 / 31 / 78) Total unusual items, -2,569; net income, 2,185.

The dissidents won 9 of 12 board seats, and immediately ousted both the Chairman and President. Unusual income items consist of -1,396 legal and other expenses related to the 1978 annual meeting of stockholders (including proxy contest) and cost of severance arrangements with prior management; -1,227 in additional accrued expenses, described in management's letter as 'fourth-quarter accounting adjustments'; -495 estimated losses on inventories and other assets and closing of branch operations; and 549 effect of a change in accounting for barge revenues.

Cook United, Inc. (12 / 28 / 74) Total unusual items, -22,089; net income, -22,064.

The dissidents elected 9 of 15 directors. The new board immediately fired the CEO and replaced him with the dissident leader. Unusual income items consist of -9,563 provision for estimated future costs of closed stores and -12,526 for estimated costs of discontinued operations.

Crown Zellerbach Corporation (12/31/85) Total unusual items, -196,500; net income, -26,800.

Sir James Goldsmith initially won 1 board seat. Two months later, he acquired 6 of 11 directorships and was named Chairman. Unusual income items consist entirely of restructuring charges. They include costs and write-downs associated with selling or closing certain operations, implementing employee and other cost reductions, and costs of legal and financial advice during the control battle with Goldsmith.

CTS Corporation (12/28/86) Total unusual items, -7,900; net income, -13,148.

While management elected all 8 directors, the Chairman was replaced within 3 weeks of the contest outcome. Unusual income items consist of -18,000 provision for disposition of a division; -7,580 expenses of the proxy contest, related litigation, and costs of selling the company; 6,299 realization of tax-loss carryforwards; 7,181 gain on disposal of discontinued operations; 3,700 from early adoption of FASB-87 on pension accounting; and 500 from accounting change to straight-line depreciation on newly-acquired assets.

Diversified Industries, Inc. (10/31/75) Total unusual items, -6,156; net income, -4,126.

The dissidents settled for 5 of 10 directorships and resignation of the CEO. Unusual income items consist of -2,425 expenses of the proxy contest and related litigation; -1,735 writedown of investment; -300 costs of unsuccessful bid on government contract; -1,550 cost of settled litigation; -162 additional provision for losses on discontinued operations; and 16 realization of tax-loss carryforwards.

EAC Industries, Inc. (1/31/79) Total unusual items, -4,368; net income, -1,676.

The dissidents elected all 10 directors. Unusual income items consist of -2,406 provision for additional losses on a previously discontinued product line; -273 expenses of the proxy contest; and -1,689 (net of 735 tax benefits) provision for losses on discontinued operations.

FGI Investors (11/30/80) Total unusual items, 1,139; net income, 726.

The President resigned 3 months after the dissidents sold their shares to a 'white knight' that management had found during the contest, and whose President replaced him. Unusual income items consist of -758 for expenses of the proxy contest; 5,135 gain from debt forgiveness and asset exchanges;

–3,144 provision for possible losses on mortgage loans probable of foreclosure; –428 loss on settlement of litigation and 334 realization of tax-loss carryforwards.

GAF Corporation (12/31/83) Total unusual items, –14,318 including gain from pension termination instigated by prior management, –36,149 without; net income, –3,841.

The dissidents won the contested board election, and their leader became CEO. Unusual income items consist of 3,527 of tax-loss carryforwards; 21,831 gain from pension termination instigated during the contest by former management and just now approved by the PBGC; –10,042 in proxy-contest expenses; –26,146 for anticipated costs of plant shutdowns; and –3,488 in anticipated expenses for moving the company headquarters.

General Refractories Company (12/31/85) Total unusual items, –2,785; net income, 4,695.

Dissidents elected the entire board, and the dissident leader was named Chairman/CEO. Unusual income items consist of –2,610 for proxy-contest expenses; –1,525 provision for severance pay; and 1,350 in tax-loss carryforwards accounted for as an extraordinary item.

Gulf Resources & Chemical Corp. #1 (12/31/82) Total unusual items, –25,392; net income, –14,743.

Dissidents elected 12 of 14 directors, and their leader was named Chairman. Unusual income items consist of –4,300 in proxy-contest expenses; –18,400 in additional provisions for previously discontinued operations; –850 from settlement of litigation over purchase agreement; and –1,842 in severance benefits for certain employees new management will continue to employ (a disputed –12,000 for terminated employees was not charged to earnings).

Gulf Resources & Chemical Corp. #2 (12/31/85) Total unusual items, 56,201; net income, 58,980.

Although the dissidents lost the election, the Chairman (who was a former dissident himself, see the entry above) resigned, selling his 20% stake in the firm. Unusual income items consist of a 7,000 gain from the first-time purchase and sale of marketable securities; –16,812 from the writedown of coal-mining assets; 45,301 from discontinued operations that consists of gains of 55,700 netted against additional provisions on prior transactions of –10,399; and 20,712 of tax-loss carryforwards.

Hoerner Waldorf Corporation (10/31/76) Total unusual items, 1,706; net income, 32,917.

The dissidents won 7 of 13 seats and immediately replaced the Chairman/CEO with their own leader. Unusual income items consist of a 697 gain on sale of a mill; and 1,009 gain for the difference between insurance proceeds received and the net book value of sawmill assets destroyed by fire.

Holly Sugar Corp. (3/31/82) Total unusual items, -8,745; net income, -2,018.

The dissidents won all 8 board seats and immediately elected their leader Chairman. Unusual income items consist of -4,747 writeoff of abandoned processing equipment; -2,565 expenses of the proxy contest; -562 expensed for consulting arrangements associated with the change in control; -391 interest penalty for failure to pay estimated federal income taxes in a prior year; -480 writeoff of obsolete inventory.

Horizon Corporation (5/31/81) Total unusual items, -9,487, net of 6,350 tax benefit; net income, -3,439.

After extensive litigation, the dissidents acquired all board seats, and a new CEO was named. Unusual income items consist entirely of the -9,487 (net of tax) costs of settled litigation over the firm's allegedly 'unfair and deceptive' land-sales practices.

Kennecott Copper Corporation (12/31/78) Total unusual items, -2,400; net income, 5,014.

The Chairman/CEO resigned during litigation over the outcome of the proxy contest. The dissidents settled 2 weeks later for 3 of 18 board seats. Unusual income items consist entirely of -2,400 in proxy-contest expenses (an additional -1,800 which management has agreed to reimburse dissidents, but which has not yet received stockholder approval, has not been accrued).

LLC Corporation (6/30/83) Total unusual items, -9,207; net income, -9,571.

The dissidents, led by Harold Simmons, acquired 6 of the 15 board seats and Mr. Simmons was elected Chairman within the year. Unusual income items consist of -10,000 writedown on finance receivables in liquidation; -763 writedown of mining ventures; and 1,556 gain on sale of building.

Louisiana Land & Exploration Company (12/31/83) Total unusual items, -12,000; net income, 94,000.

During litigation over the contest outcome, the CEO resigned. Unusual income items consist entirely of a -12,000 writedown of copper operations.

Management Assistance Inc. (9/30/84) Total unusual items, -12,712; net income, -8,213.

The dissidents, led by Asher Edelman, won 4 of 10 seats on the staggered board. The CEO/President/Chairman resigned 5 months later. Unusual income items consist of -3,920 in direct expenses for the proxy contest; -4,200 unamortized costs of restricted stock grants released due to the election of dissident directors, and charged to earnings; -8,129 in severance and pension benefits for terminated employees; -2,502 estimated cost of curtailment of a product line; 300 in tax-loss carryforwards; 1,063 for the cumulative effect of a change in accounting for sales commissions; -2,498 writeoff of goodwill; and 7,174 tax benefit due to reversal of deferred income-tax provisions on undistributed earnings of its Domestic International Sales Corporation which became nontaxable under the Tax Reform Act of 1984.

New Jersey Resources Corporation (9/30/87) Total unusual items, 0; net income, 11,239.

The dissidents ended the contest by selling their shares to the firm at a premium. The Chairman, who was also the company founder, resigned a year and 4 months later. There are no unusual income items.

Orange-co, Inc. (8/31/86) Total unusual items, -5,654; net income, -3,451.

Dissidents elected all directors. Unusual income items consist of -2,300 writedown of citrus assets; 228 gain on sale of real estate; -1,900 for the closing of the Columbus, Ohio office, severance pay for certain employees, and expenses of waging the proxy contest (no breakdown provided); and -1,682 in additional reserves for the firm's contingent liability for leases of a former wholly-owned subsidiary.

Penn Traffic Company (1/31/87) Total unusual items, -1,923; net income, 7,300.

The dissidents simultaneously waged a proxy contest and tendered for all shares. They failed to win board seats, but ultimately (8 months later)

succeeded in acquiring the company via tender offer. Unusual income items consist of -2,204 proxy-contest and merger expenses; -83 provision for store closings; 524 effect of early adoption of FASB-87; and -160 costs of acquiring another company.

Plant Industries Inc. (12/31/80) Total unusual items, -2,324; net income, -1,897.

Dissidents elected 6 of the 9 directors, named the other 3 from the old board, and immediately replaced the Chairman with their leader. Unusual income items consist of 1,252 gain on sales of assets; -1,136 expenses of the proxy contest, including the former Chairman's salary claims; -1,173 write-downs of tangible assets taken by new management; -525 writedowns of intangible assets taken by new management; and -742 (net of tax) loss from discontinued operations.

H.H. Robertson Co. (12/31/86) Total unusual items, 1,736; net income, -41,843.

The dissidents negotiated a settlement with management that gave them 3 board seats. Six months later, the President/CEO took early retirement. Unusual income items consist of -4,438 in reorganization costs; -5,015 for settled patent litigation; 4,513 gain on sale of investment; 4,443 gain on pension-plan reversion; and 2,233 income from discontinued operations (net of tax).

Southdown, Inc. (12/31/76) Total unusual items, -31,553; net income, -16,786.

The dissidents acquired 6 of 9 board seats, and the CEO resigned. Unusual income items consist of a goodwill writeoff of -22,700; a -2,100 writedown of a sugar mill; and -6,753 (net of tax) anticipated costs of discontinued operations.

TelePrompTer (12/31/72) Total unusual items, 0; net income, 12,579.

The parties negotiated a compromise slate that gave the dissidents a majority of the directorships, and the Chairman/CEO resigned. There are no unusual income items.

Tenna Corporation (1/31/79) Total unusual items, 557; net income, 37.

The dissidents won 5 of 7 board seats, and the CEO resigned. Unusual income items consist of 425 cumulative effect of a change in accounting for inventories and 132 reversal of estimated tax accruals.

Vornado Inc. (1/31/81) Total unusual items, -2,000; net income, -3,562.

The dissidents initially won 3 of 9 seats on a staggered board. Ultimately, they acquired a majority of seats and the President resigned. Unusual income items consist of -600 loss provision and -1,400 costs of ceasing a product line.

Wieboldt Stores Inc. (1/29/83) Total unusual items, 2,396; net income, -1,930.

Three dissident groups waged proxy contests. All board seats went to dissidents and the Chairman resigned. Unusual income items consist entirely of a gain on sale of real estate.

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