The Use of Advertising Activities to Meet Earnings Benchmarks: Evidence from Monthly Data
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Contributions

- Examine quarterly as opposed to annual earnings benchmarks
- Separate advertising from other discretionary expenses
- Consider increasing advertising to boost sales as an earnings management activity
- Investigate the timing of manipulation using monthly advertising data
- Use a proprietary dataset of actual advertising activities via television, print, radio, and internet.
General difficulties of detecting real manipulation

- How to measure abnormal real transactions?
  - Demands understanding the nature of the operation

- How to prove they are suboptimal decisions?

- A joint test of real manipulation proxies and earnings management suspects manipulating real transactions.

- Multiple tools available to managers are likely substitutive (Zang, 2006): accrual manipulations, various types of real transactions, expectation managements.

- What is the pecking order of the tools?
Concerns – proprietary advertising data

- The data capture mostly outsourcing advertising activities, which count for 44% (20% for median) of the total advertising expenses.

- Outsourcing advertising might be more difficult to manipulate due to the involvement of a third party.
  - “Signing an upfront commitment to TiVo makes sense for us …,” said Deborah Meyer, VP Marketing, Lexus.
  - “As Christmas decorations get packed away, media buyers are already thinking about the upcoming holiday season.”
  - “With an advertising commitment of around $20 million in media time and involvement in the actual show, Nissan USA’s deal with ABC’s Desperate Housewives goes beyond its announced promotion with the show’s DVD release.”
  - “Cars.com, …announced Monday that it planned to buy an ad during next year’s Super Bowl.”

- What are the rest (56%/80%) of the advertising activities? Are they more flexible to manipulate?
  - Outdoor billboard, one–time campaigns, free samples, public relation, special events, etc.

- More discussion about the media–tracking company: any selection bias?
Firm-specific time-series model following Foster [1977] model for quarterly earnings:

\[ X_t = \theta_1 X_{t-12} + \theta_2 (X_{t-1} - X_{t-13}) + \epsilon_t \]

How good is the time-series model?
- Fama-MacBeth t-stats for \( \theta_1 \) and \( \theta_2 \) not significant
- \( R^2 \)’s of the time-series models?

Do quarterly earnings and monthly advertising share the same time-series dynamics?
Can you use Box-Jenkins analysis?

Cross-sectional model with determinants identified in marketing research?
- Competitor’s advertising activities
- Current sales level
- General competition
- Other substituting marketing activities: sales discounts, price cut, rebates, incentives

What if firms manipulate advertising regularly?
- Simply plot \( (X_t - X_{t-12}) \) by months?
- Why are residuals suboptimal activities?
Other concerns and suggestions

- The paper explores the idea of meeting an earnings benchmark by boosting advertising
  - Is it still manipulation if the benefit outweighs the cost?

- Cross-sectional variations in the costs of cutting advertising?
  - Lev and Sougiannis, 1996

- Cash constraint?

- Any other differences between suspect firms and non-suspects?

- Do firms postpone advertising to the next month instead of cutting it?
Conclusions

- This paper presents interesting new evidence on manipulating advertising activities to achieve quarterly earnings benchmarks.
  - Separating advertising activities from other discretionary expenses

- Major challenge:
  - Increase the power of abnormal advertising proxy
  - Incorporate the costs of manipulating advertising