Evaluating Firms’ Benchmark Behavior Over Time: The Counting Heuristic

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Abstract: Market participants frequently evaluate a firm’s ability to meet or beat their earnings expectations over multiple time periods. Although prior research reports that firms that consistently beat their earnings expectations are rewarded with a market valuation premium, most firms are inconsistent in their benchmark behavior. In this paper, we report the results of multiple experiments to test the idea that investors, evaluating firms that have inconsistent benchmark performance, use a counting heuristic to discriminate among firms. Our results provide strong support for the hypothesis that investors distinguish among firms by counting the number of misses and beats they experience over a particular time period. This fairly simple counting heuristic is used even though investors also have available to them information about how those firms differ on another important measure—namely, the magnitude of their earnings. Our study has implications for researchers, firm managers and regulators.

KEYWORDS: Benchmark performance; earnings magnitude; counting heuristic

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