




# The association between optimism and future performance: Evidence of impression management from chief executive officer and chairperson letters

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**Purpose:** This article examines the sincerity of two sets of narrative disclosures in the letters of chairpersons (CPs) and chief executive officers (CEOs) to stakeholders. The study sought to compare the level of optimism between the two letters and whether such optimism (as per its link to future performance) was sincere or not and the differences in the level of sincerity between the two letters.

**Design/methodology/approach:** Chairpersons' and chief executive officers' letters as contained in annual reports for firms listed on the Johannesburg Stock Exchange over a 4-year period were analysed. Textual analysis software was used to measure optimism in 200 CPs' and 200 CEOs' letters. The level of optimism was compared using mixed-model repeated measures analysis of variance. Sincerity was operationalised as the positive association between the level of optimism and future performance and a negative association as evidence of impression management. Two-way linear fixed effect regression models were used.

**Findings:** This study found that CPs' letters were more optimistic than those of CEOs'. More specifically, the results point to impression management in both CPs' and CEOs' letters, with only CPs' letters indicating a significant negative association.

**Practical implications:** Relative to the CEOs, CPs may use more optimistic writing styles to sway stakeholders who are anticipating worse-than-expected future performance; readers should be aware of the potential consequences of such practices.

**Originality/value:** The results provide support for the obfuscation hypothesis as a theoretical underpinning regarding CPs' and CEOs' letters. Overall, the results question the ability of such narratives to lessen agency costs.

**Keywords:** corporate governance; chief executive officer; chairperson; DICTION; impression management; narrative tones; optimism; sincerity.

## Introduction

While the initial purpose of accounting was to report only quantitative financial information on the past performance of a company, modern accounting aims to report on the value-creation process. The notion that nonfinancial or qualitative information, also referred to as narratives, including management commentary, is paramount in achieving the aim of value creation seems to be well supported by empirical evidence.

Research by Cenesizoglu and Timmermann (2012) showed that quantitative financial information on its own does not explain changes in market value. More specifically, research by Ocean Tomo (2015) showed a dramatic increase in the contribution of intangible assets (IA) (often not reflected in financial statements) to the market value of the Standard and Poor (S&P) 500 from a mere 17% in 1973 to 87%. Finally, the importance of narratives to users of financial statements is well supported by empirical evidence (Abrahamson & Amir, 1996; Bartlett & Chandler, 1997; Bonsall & Miller, 2017; Craig & Amernic, 2018; Epstein & Pava, 1993; Lee & Tweedie, 1981; Mmako & Jansen Van Rensburg, 2017; Shin & You, 2020; Smith & Taffler, 2000). Bartlett and Chandler (1997) established the chairperson's (CPs') letter as the single most read section in the annual report.

Despite the importance of the CPs' letter, the inclusion of specifically the letters of the chief executive officer (CEO) and the CP as narratives in a dedicated section of the integrated annual

reports appears unregulated and voluntary to a large extent. In South Africa, the *Companies Act of 2008* in section 30(3) merely requires that annual financial statements must include a letter by the directors (South Africa, 2008). In a similar vein, the King IV Code of Corporate Governance (King IV) only requires that the board should include commentary on the financial results (Institute of Directors South Africa [IoDSA], 2016). Both the International Integrated Reporting Framework and the Johannesburg Stock Exchange (JSE) listing requirements are silent on this matter.

Regarding the assurance of CPs' and CEOs' letters, the external auditor is only required to state whether the information in the director's letter is consistent with the financial statements, instead of verifying the completeness thereof (International Auditing and Assurance Standards Board, 2009). The CEO and the CP are therefore given free rein to discuss and explain the financial performance and outlook of the company with minimum mandatory constraints, which is sometimes perceived and studied as a deliberate attempt to influence perceptions through impression management (Bowen, Davis, & Matsumoto, 2005; Merkl-Davies & Brennan, 2007; Yuthas, Rogers, & Dillard, 2002).

Given their role and responsibilities within a company, the CP (head of the board of directors) – mostly an independent nonexecutive director as recommended by King IV (2016) – is required to hold an objective viewpoint of the affairs of the company. In contrast, the CEO is regarded as the highest-ranked individual, who is required to be more intimately involved in the affairs of the company (Deloitte, 2014). Arguably, as a result of the principles of King IV, stakeholders can therefore expect CPs' letters to be more objective because of their independent and nonexecutive status and therefore less likely to unduly influence stakeholders' perceptions, relative to CEOs' letters.

This study adds to the existing knowledge on accounting narratives, especially their role in impression management, as well as to the ongoing debate on CEO duality (the practice of a single person serving as both CEO and CP of the board), through performing this study in an environment where the separation of the roles is encouraged. The King IV principles, with which JSE-listed companies are expected to comply, are grounded in ethical and effective leadership as supported by the principles of good governance and further pioneered the shift from CEO duality to separate positions (IoDSA, 2016). Palanissamy (2015) notes that most listed companies in South Africa separate the CP and CEO roles as encouraged by the King Code of Corporate Governance; hence the majority of listed firms separate the roles of CEO and CP in South Africa (IoDSA, 2016). Salvioni, Almici and Bosetti (2012) note that the BRICS countries (Brazil, Russia, India, China and South Africa), which represent a mix of developed and developing countries, except for Russia, endorse the nomination of the separation of CP and CEO positions, as per the International Corporate Governance Network recommendation. Several studies underline the ability of

corporate governance to constrain impression management (García Osma & Guillamón-Saorín, 2011; Mather & Ramsay, 2007). This study, using a sample where the CEO and CP are different people and given the CP in the role as an independent nonexecutive director and the CEO as an executive director, expects the CPs' letters' narrative to be more sincere than the CEOs' letters. Furthermore, the agency theory suggests that greater information asymmetry should exist in communications from CPs who are informed by the CEO and other C-suite staff of operations and financial performance. Thus, for JSE-listed companies, the focus of this study was on the difference between CEOs' and CPs' letters regarding their respective use of impression management. The sample was defined as the CEOs' and CPs' letters of large (in terms of market capitalisation) JSE-listed companies over a 4-year period (2016–2019). As far as could be ascertained, this was the first study that has explicitly sought to separately compare the CEOs' and CPs' letters in an impression management context using data from an emerging economy.

Similar to the notion applied by Patelli and Pedrini (2014), although performed in a South African context of unstable economic growth and notably not within a context of an economic crisis, this study interpreted a positive association between the level of optimism and future performance as more sincere reporting and the absence of impression management, as opposed to a negative or no association, which may be indicative of impression management. The findings of Patelli and Pedrini (2014), as made within the context of an economic crisis, suggest that future research should explore the effect of different economic contexts on CEO communication styles. Although different economic contexts are relevant, this study was performed at the individual company level over a number of financial years, therefore taking into account the effect of the movement in financial performance over the period and in turn accounting for the various economic contexts that the sample firms may have experienced during the period under review. Furthermore, and more specifically, the purpose of this study was to examine the sincerity (and therefore the absence of impression management) of two sets of narrative disclosures in the letters of CPs and CEOs to stakeholders.

At a theoretical level, this study aimed to examine the ability of narratives, specifically CEOs' and CPs' letters, to lessen agency costs and associated information asymmetry, as well as the suitability of the obfuscation hypothesis to explain differences between these two types of letters. The King Code of Corporate Governance, in its promotion of good corporate governance, has pioneered and advocated the shift from CEO duality to separate positions that formed the basis of the analysis of sample firms with two separate reports (IoDSA, 2016). Through its methodological design, the study specifically contributes to the literature in contrasting the two types of letters. Several studies have underlined the ability of corporate governance to constrain impression management (García Osma & Guillamón-Saorín, 2011; Mather & Ramsay, 2007).

To achieve this purpose, the following three research questions were asked:

1. Is there any difference in the level of optimism displayed in CEOs' letters in comparison with CPs' letters?
2. Is the displayed optimism (as per its link to future performance) in the respective CEOs' and CPs' letters sincere?
3. Are there any differences in the level of sincerity between CEOs' and CPs' letters?

The findings show that CPs' letters were more optimistic than those of CEOs. Furthermore, while the findings for both the CEOs and CPs show a negative association between optimism and future performance, as a proxy for impression management and evidence of the obfuscation hypothesis, it is noted that this association is only significant for the CPs' letters. On the basis of the King Code of Corporate Governance and its advocacy for the separation of the roles of the CEO and CP for good corporate governance and given the CP in the role as an independent nonexecutive director and the CEO as an executive director, the study expected CPs' letters' narrative to be more sincere than CEOs' letters. The findings show, however, that the CPs' letters, relative to the CEOs' letters, are most likely to be insincere in their narratives with respect to future performance, which suggests that users of integrated reports should therefore rely less on the CPs' letter relative to the CEOs' letter in terms of the level of optimism in relation to potential future performance. The agency theory, which suggests that through the reporting structures greater information asymmetry should exist in communications from the CPs, who are informed by the CEO and other C-suite staff of operations and financial performance, was therefore not supported by the findings. Pragmatically, the results of this study will be of specific interest to stakeholders such as integrated annual report users who read and rely on these letters for decision-making purposes, as well as regulatory bodies such as the JSE, IoDSA and codes aiming to continually improve corporate governance.

Although this study is situated in the voluntary disclosure domain, the quality of JSE companies' mandatory financial reporting is well known given South Africa's dominance in World Economic Forum rankings for auditing and reporting strengths, notwithstanding state capture and other corporate scandals (Independent Regulatory Board for Auditors, 2017). Through the King Code of Corporate Governance III report, JSE-listed companies in South Africa were further among the first internationally to adopt the principles of the International Integrated Accounting Framework in 2010, which contains separate reports from both the CEO and CP. The South African context for JSE-listed companies, wherein it is strongly advised that the CEO and the CP should not be the same person, offered a unique research context and setting within which to explore impression management in narratives and specifically by analysing whether the separation of these roles would constrain the evidence of impression management within these respective types of letters.

The next section provides an overview of relevant existing literature to position this study theoretically and to emphasise its contribution to the body of knowledge. This is followed by a discussion of the research design and methods applied in the study. Thereafter, the results are presented to answer the research questions. The article concludes with a discussion of the key lessons learned, the study limitations and suggestions for further research.

## Literature review

The purpose of this literature review is to illustrate what is known about the interrelationships between impression management, company performance, corporate governance and sincerity.

### Background and theoretical lens

Impression management, in contrast to earnings management, which entails the use of accounting policies and estimates to achieve certain outcomes, is concerned with narratives and the presentation of information and forms the focus of this study.

Impression management refers to either emphasising positive organisational performance or as obfuscating negative organisational performance (Merkl-Davies, Brennan, & McLeay, 2011). Disclosures in CEO and CP narrative letters are voluntary disclosures guided by the King IV principles. The obfuscation hypothesis assumes underlying levels of information asymmetry caused by market inefficiencies, such as variation in voluntary disclosure levels in CEO or CP narrative letters (Aerts, 2005; Clatworthy & Jones, 2003; Courtis, 1998; Merkl-Davies & Brennan, 2007). The agency theory proposes that the motive for disclosure stems from information asymmetries, whereby an unequal distribution of information exists between managers, such as the CEO as the agent and the shareholders as the principals (Deegan, 2014). Impression management may involve the use of biased discretionary reporting to exploit information asymmetries (Aerts, 2005; Merkl-Davies & Brennan, 2007). Davidson, Jiraporn, Kim and Nemeč (2004) propose that impression management represents an agency cost when it obscures economic results and clouds the ability of all stakeholders to make financial decisions.

The legitimacy theory, as developed by Dowling and Pfeffer (1975), suggests that voluntary disclosures, such as those in CEO and CP narrative letters, are made to legitimise corporate operations. Impression management, through voluntary disclosure by obfuscating failures and emphasising successes, may thus occur to enhance the corporate image and maintain organisational legitimacy (Patelli & Pedrini, 2014). Yuthas et al. (2002) argue that organisational legitimacy may play an important role in influencing the tone of discretionary narrative disclosure in constraining impression management.

Various impression management strategies have been identified in the literature, such as reading ease manipulation

(Baker & Kare, 1992; Courtis, 1986), thematic manipulation (Clatworthy & Jones, 2003; Guillamón-Saorín, 2006), visual and structural effects (Courtis, 1996; Guillamón-Saorín, 2006), performance comparisons (Short & Palmer, 2003), choice of earnings number (Guillamón-Saorín, 2006) and attribution of organisational outcomes (Aerts, 2005; Clatworthy & Jones, 2003). One such impression management strategy, namely rhetorical manipulation (Sydserff & Weetman, 2002; Yuthas et al., 2002), includes optimistic rhetorical tone ('optimism') and forms this study's proxy for impression management. Du Toit and Esterhuysen (2021) found optimism to be a commonly used narrative style in South African CEOs' shareholder letters and note this to be similar to the findings of a study of international companies as indicated in Craig and Amerinc (2018).

### Impression management through a corporate governance lens

Mather and Ramsay (2007) note that boards with higher levels of independency in their compositions have limited impression management. Similarly, Agyei-Mensah (2016) and García Osma and Guillamón-Saorín (2011), upon examining the association between the strength of corporate governance and impression management, found that strong governance mechanisms monitoring managerial disclosures limit impression management. Boards where the same person holds the position of both CEO and CP are typically deemed to have relatively weaker monitoring of corporate managers and thus less transparency. However, after analysing corporate reporting transparency, board independence and CEO duality, Felo (2010) suggests that while enhancing board independence may improve corporate reporting transparency, separating the role of the CEO and the CP may not. Those in favour of more effective corporate governance argue for independent board leadership and thus advocate that the CEO should not also be the CP of the board (Rechner & Dalton, 1991). Where the CEO is also the CP, CEO duality weakens the effectiveness of the board in terms of control and monitoring functions (Boyd, Gove, & Hitt, 2005). Chief executive officer duality is assumed to hinder the effective governance of a company (Dey, Engel, & Liu, 2011). Within the South African context, and according to King IV, the CEO forms a link between management and the board of directors (IoDSA, 2016). On the other hand, the CP as an independent nonexecutive director has a supervisory role with the primary responsibility of providing leadership to the board of directors (IoDSA, 2016). It is strongly advised that the CEO should not also be the CP (IoDSA, 2016). The agency theory is an important theoretical basis for an arrangement where the roles of the CEO and the CP are separated (Li, Huang, Huo, & Li, 2021). The arguments for separating the roles of the CP and CEO are compelling given that separation provides boards with a structural basis with which to oversee management and limits potential asymmetries of information (Cunha & Rodrigues, 2018).

A review of the literature that analyses impression management in CEO's and CPs' letters shows that the lines

between the roles of the CEO and CP are generally blurred in their corporate narratives. This study therefore undertook to examine and distinguish the levels of optimism, as a proxy for impression management, across CEOs' and CPs' letters.

### Impression management and company performance

The literature suggests that companies are expected to strategically influence stakeholder perceptions about their financial position by using accounting narratives in a self-serving way instead of reporting performance objectively. Leung, Parker and Courtis (2015) found a negative association between minimal narrative disclosure and changes in future performance. They suggest that concealment behaviour of minimal narrative disclosure is a deliberate impression management strategy to conceal information about persistently poor performance to divert investors' attention away from a company's weakness or negative news. Similarly, Ajina, Laouiti and Msolli (2016) found that when managers notice a decline in performance, they attempt to hide future negative performance by increasing the complexity of their annual report readability and financial statements. Aerts (2005) contends that a financial performance downturn constitutes a prominent signal for impression management, while a financial performance upturn does not.

In contrast, Merkl-Davies et al. (2011), relying on a content analysis of CPs' statements of companies listed in the United Kingdom, found that negative organisational outcomes prompt managers to engage in retrospective sense-making, which involves retrospectively assigning causes to these outcomes instead of presenting an image of organisational performance that is inconsistent with the internal views of management. Similarly, from a research and development disclosure lens, Merkley (2014) discovered a negative relationship between narrative disclosure and earnings performance adjusted for the research and development expense. This suggests that managers adjust research and development disclosures based on earnings performance to provide relevant information in response to investors' changing information demands. Merkley (2014) further found no evidence that managers generally use disclosure to obfuscate performance. Similarly, Yan, Aerts and Thewissen (2019) suggest that rhetorical impression management features in top management narratives provide sensitive and incremental information that influences the insights of stock market participants. This suggests that impression management is both self-presentational and information-sharing despite being theorised as manipulative and lacking true information content. Furthermore, Patelli and Pedrini (2014) found optimistic tone to be congruent with both past and future performance and suggest that under tough macroeconomic conditions, incentives to distort public information strategically are low and firms are instead likely to engage in communicative action aimed at dialoguing with shareholders by way of sincere disclosure.

While the literature yields mixed results in terms of the use of impression management strategies by management in either a self-serving way to obfuscate performance or by providing incremental performance information to users, it supports the notion of a clear use of corporate narrative disclosures to describe current and future company performance.

### Sincerity in corporate narratives

Yuthas et al. (2002), in their analysis of the Management Discussion and Analysis (MD&A) and Presidents' Letter sections of annual reports, note that companies exhibited corporate narratives that were relatively more communicative than strategic in nature, regardless of whether the earnings forecast expectation was good or bad. Yuthas et al. (2002) challenge the obfuscation hypothesis of the impression management theory and suggest that the sincerity of corporate narratives is observed if positive (optimistic) rhetorical tone is supported by good performance. A shortcoming of Yuthas et al.'s (2002) research, as well as of this study, is that the narratives were not analysed to distinguish whether discussions were focused on past, current or future financial years. However, it is suggested that because of the fact that narratives were placed in the integrated report, which is an overview of the current financial year, that such narratives would be focused on the present year and the future outlook. On examining the sincerity of optimism in CEOs' letters to shareholders, Patelli and Pedrini (2014) similarly found optimism to be supported by future company performance. Patelli and Pedrini (2014) therefore indicate that even under tough macroeconomic conditions, incentives to report, strategically, are low and that companies tend to engage in sincere communicative action with shareholders. Consequently, the obfuscation hypothesis of impression management is ultimately rejected in the literature. Patelli and Pedrini (2014) suggest that where rhetorical tone is not continuously supported by past and future company performance, the CEOs' reputation would be threatened, and as such would go against the self-serving behaviour stressed by impression management studies.

However, when analysing CPs' letters and managers' letters with respect to optimism and its relationship with performance, Sydserff and Weetman (2002) found evidence of impression management that suggests that managers of poor performers may use impression management in narratives to resemble the verbal tone of good performers. Based on their study, Zerfass and Sherzada (2015) commented that advanced visions of strategic communication developed in academia and practice had not yet arrived in many boardrooms. With respect to optimism as a proxy for impression management, the literature, predominantly based on studies in the United States of America, shows mixed evidence of the use of impression management within various managerial letters.

## Method

This section discusses the selection of the study sample, the proxy used to measure optimism, as well as the bivariate and

multivariate regression analyses that were used to answer the three research questions set to achieve the purpose of this study.

### Study sample

For this study, the sample was defined as 50<sup>1</sup> large (in terms of market capitalisation [MCA]) JSE-listed companies as on 31 December 2019, for which separate CEOs' and CPs' letters were available for 4 financial years (2016, 2017, 2018 and 2019). A requirement to be included in the sample was that the firm had to produce a separate CEOs' and CPs' letter in the relevant year. A total of 200 CEOs' and 200 CPs' letters were examined, 50 letters per CEO or CP per year. Johannesburg Stock Exchange-listed companies were selected as they are required to comply with King IV, which makes a clear distinction between the role of the CEO and the CP and discourages CEO duality (IoDSA, 2016).

Although the sample was admittedly biased towards larger companies, it is noteworthy that the combined MCA of the study sample represented almost 50% of the total JSE MCA as on 31 December 2019 (R6742 billion out of R14017 bn).

### Measurement of optimism

Studies, such as by Sydserff and Weetman (2002), associate optimism, as calculated by the narrative analysis software program DICTION, with impression management. This study, following a similar approach, identified the optimism score as a proxy for optimism, as computed by DICTION (Hart & Carroll, 2015), a well-known rhetorical analysis software program, and although admittedly not without criticism, often used in empirical research to examine corporate narratives (Cho, Roberts, & Patten, 2015; Du Toit & Esterhuysen, 2021; Sydserff & Weetman, 2002; Yuthas et al., 2002). DICTION defines optimism as 'language endorsing some person, group, concept or event, or highlighting their positive entailments' (Hart & Carroll, 2015). For optimism, DICTION standardises six variables and then adds or subtracts them as follows: (praise + satisfaction + inspiration) – (blame + hardship + denial), adds a constant of 50, and then provides a slight statistical correction by referencing DICTION's normative databank. According to DICTION'S definitions of these six variables, the program tracks the use of these six variables in the input text of the CPs' and CEOs' letters and provides a standardised score based on frequency counts of words in each dictionary. DICTION uses wordlists to search a text for its five master variables, namely Optimism, Activity, Certainty, Realism and Commonality. Prior studies indicate that although it has some limitations, DICTION possesses robust empirical validity (Alexa & Zuell, 2000; Blich, Kohles, & Meindl, 2004; Ober, Zhao, Davis, & Alexander, 1999; Short & Palmer, 2008). Its automated procedure is deemed to be based on rigorous theoretical

<sup>1</sup>The list of 50 JSE-listed companies that constituted the sample can be found in Appendix 1 to the article.

foundations to ensure objectivity and measurement validity (Davis, Piger, & Sedor, 2012; Patelli & Pedrini, 2014).

Patelli and Pedrini (2014) suggest that DICTION is appropriate for the analysis of CEO communication, while Sydserff and Weetman (2002) suggest that DICTION is a useful tool for studies that seek to investigate impression management. Du Toit and Esterhuysen (2021), for example, relied on DICTION software to conduct a narrative analysis of South African CEOs' shareholder letters for a single financial year. For this study, DICTION was used as a rhetorical analyser for both CEOs' and CPs' letters.

Research Question 1 was: is there any difference in the level of optimism displayed in CEOs' letters in comparison with CPs' letters?

To answer Research Question 1, mixed-model repeated measures analysis of variance (ANOVA) was performed using the optimism proxy discussed above.

Research Question 2 was: is the displayed optimism (as per its link to future performance) in the respective CEOs' and CPs' letters sincere?

To answer Research Question 2, multivariate regression tests were carried out. For the purpose of this study, sincerity was operationalised as the positive association between the level of optimism and future performance as the dependent variable. A negative or the absence of such an association, on the other hand, was interpreted as evidence of impression management. Return on Assets (ROA) is an extensively used measure of company performance (Sharma, Shebalkov, & Yukhanaev, 2016; Waddock & Graves, 1997) and was therefore used as the proxy for performance in this study.

Besides the level of optimism, a number of other control variables were included in all multivariate regression models. Past performance, in terms of prior-year ROA, was included in the panel regression model as a control variable to measure the marginal effect of optimistic rhetorical tone on future performance. The study also included a loss dummy variable (Loss) to distinguish loss-making from profit-making companies (Li, 2008; Patelli & Pedrini, 2014). Directors' shareholding (DSH) is the number of shares held by executive and nonexecutive directors of the board, which was added to control for the effect of directors' self-interest on performance and breadth of readership.

Following Patelli and Pedrini's (2014) suggestion to adopt the use of a comprehensive measurement of DICTION's rhetorical analysis features, this study controlled for potential competing rhetorical strategies. By controlling for the Activity, Certainty, Realism and Commonality DICTION measures, this study controlled for the four other DICTION

master variables<sup>2</sup> in the study's panel regressions. All other variables were obtained from the Iress<sup>3</sup> database.

The study considered the effects of strategy and opportunity to grow through taking into account the price to book ratio (PB) (Patelli & Pedrini, 2014). Leverage (Lev) was added to control for capital structures' effect on the growth of future performance (Patelli & Pedrini, 2014).

The IA to assets ratio were included to control for capital intensity (Patelli & Pedrini, 2014). Company size was controlled for by including the natural logarithms (ln) of total revenue (TotalRev) and the number of employees (Employees) and MCap in the panel regression models (Patelli & Pedrini, 2014). Size was controlled for because of its impact on disclosure and remuneration levels. Finally, to decide which panel data regression model to use, *F*-tests were performed to choose between the pooled ordinary least squares and fixed effect regression models. In all cases where the null hypothesis was rejected, a second *F*-test was performed to choose between the one-way and two-way fixed effects regression models.

As discussed above, the following regression models were therefore used to answer the second research question:

$$\begin{aligned} \text{FROA} = & \alpha_0 + \alpha_1 \text{optimism (letter)} + \alpha_2 \text{Activity (letter)} \\ & + \alpha_3 \text{Certainty (letter)} + \alpha_4 \text{Realism (letter)} \\ & + \alpha_5 \text{Commonality (letter)} + \alpha_6 \text{Past ROA} \\ & + \alpha_7 \text{PB} + \alpha_8 \text{IA} + \alpha_9 \text{TotalRev} \\ & + \alpha_{10} \text{Employees} + \alpha_{11} \text{Loss} + \alpha_{12} \text{MCap} \\ & + \alpha_{13} \text{Lev} + \alpha_{14} \text{DSH} + \varepsilon \dots \end{aligned} \quad [\text{Eqn 1}]$$

Where future return on assets (FROA) is future performance in the subsequent year, Past ROA is the ROA of the prior year; PB is the PB for the current year; IA is the intangible assets for the current year; TotalRev is the revenue for the current year; Employees is the number of employees for the current year; Loss is a dummy variable for loss-making firms; MCap is the ln of MCap for the current year; Lev is leverage for the current year; and DSH is the director shareholding for the current year. Note that DSH will reflect the shareholding of all directors, and not only that of CPs' and CEOs', which is noted as a limitation of the study.

As Research Question 2 aimed to investigate both CEOs' and CPs' letters, two separate regression models were performed. In the first model, 'letter' in the above regression model therefore referred to CEOs' letters, and in the second regression to CPs' letters. As discussed, Optimism, Activity, Certainty, Realism and Commonality were all measured using DICTION. Analyses were performed for each of the above two models to ensure there were no violations of the

2. Refer to DICTION 7.1 Help Manual (Hart & Carroll, 2015) for the definitions of DICTION's five master variables.

3. Iress is a technology company that provides software to the financial services industry in the Asia-Pacific region, North America, Africa and Europe. Iress software is used by more than 9000 businesses and 500 000 users globally.

following regression assumptions: normality, multicollinearity, homoscedasticity and autocorrelation. Normality was assessed by inspecting normal probability plots, multicollinearity by calculating variance inflation factors, homoscedasticity by examining residual plots and autocorrelation by calculating Durbin–Watson test statistics. Research Question 3 was: are there any differences in the level of sincerity between CEOs' and CPs' letters?

King IV, which promotes good corporate governance, advocates for the separation of roles between the CEO and CP (IoDSA, 2016). The agency theory suggests that through the reporting structures greater information asymmetry should exist in communications from CPs, who are informed by the CEO and other C-suite staff of operations and financial performance. This study, using a sample where the CEO and CP are different people and given the CP in the role as an independent nonexecutive director and the CEO as an executive director, expected CPs' letters' narrative to be more sincere than CEOs' letters.

Further to a comparison of the regression results, robustness tests were performed to analyse the positive and negative components of optimism for both CEOs' and CPs' narrative letters using positive composite scores (POS Score), optimism's negative composite scores (NEG Score) and future performance for both CEOs' and CPs' narrative letters. To ensure that there were no violations of the regression assumptions, the same tests and inspections as discussed above were performed before the results of these robustness tests were reported.

Given that optimism as computed by DICTION comprises both positive and negative components, the following two self-constructed composite scores were used as independent variables in this study's robustness tests:

- POS SCORE: The total positive components of optimism were computed as the sum of Praise, Satisfaction and Inspiration.
- NEG SCORE: The total negative components of optimism were computed as the sum of Blame, Hardship and Denial.

The results of the robustness tests are shown in Table 2.

## Ethical considerations

This article followed all ethical standards for research within the Humanities & Social Sciences Research Ethics Committee at Stellenbosch University, who granted full approval for this research (ref. no. ACC-2021-22898).

## Results

The results section commences with descriptive statistical analysis followed by a mixed-model repeated measures ANOVA to answer Research Question 1, which is followed by the results of the panel regressions and the robustness tests to answer Research Question 2 and 3.

**TABLE 1:** Descriptive statistical analysis.

Variable	Mean	Minimum	Maximum	Standard deviation
<b>Panel A: Dependent variable (FROA) and control variable (PROA)†</b>				
ROA (2015)	7.77	-11.92	46.85	10.48
ROA (2016)	8.11	-14.68	35.61	10.27
ROA (2017)	7.97	-14.68	35.61	10.21
ROA (2018)	7.16	-19.23	40.35	11.24
ROA (2019)	7.46	-6.83	40.32	10.01
ROA (2020)	6.02	-17.38	47.22	11.56
<b>Panel B: Independent variables (2016–2019)</b>				
Optimism: CEO	53.23	44.40	58.37	2.01
Optimism: CP	53.57	49.40	59.62	1.93
Positive construct score: CEO	16.91	1.40	33.18	6.76
Positive construct score: CP	18.33	3.25	38.85	6.09
Negative construct score: CEO	3.33	0.12	13.51	2.60
Negative construct score: CP	4.08	-	12.61	2.37
<b>Panel C: Other control variables (2016–2019)</b>				
Activity: CEO	48.74	24.39	56.39	4.14
Activity: CP	48.33	27.08	53.08	3.02
Certainty: CEO	44.72	29.54	50.82	3.66
Certainty: CP	45.71	19.85	52.44	4.62
Realism: CEO	44.41	35.28	52.91	2.47
Realism: CP	44.58	35.46	50.41	2.43
Commonality: CEO	51.20	41.09	58.40	2.28
Commonality: CP	51.03	46.31	60.78	1.86
Praise: CEO	5.16	-	16.39	3.11
Praise: CP	5.91	-	16.91	2.97
Satisfaction: CEO	3.93	-	14.37	2.76
Satisfaction: CP	5.08	-	14.86	2.85
Inspiration: CEO	7.82	0.38	27.41	4.13
Inspiration: CP	7.35	0.97	19.89	3.46
Blame: CEO	0.77	-	13.23	1.31
Blame: CP	0.89	-	11.49	1.22
Hardship: CEO	1.47	-	8.42	1.48
Hardship: CP	2.09	-	8.88	1.57
Denial: CEO	1.08	-	6.93	1.19
Denial: CP	1.11	-	6.21	1.10
PB	2.71	0.33	12.15	2.57
IA to total assets ratio	0.10	-	0.85	0.15
Revenue (ZAR billion)	115.78	1.47	310.83	392.22
Number of employees	28 468.00	32.00	158 000.00	30 260.00
Market capitalisation (ZAR billion)	99 450.08	19 940.88	938 767.84	146 954.62
Leverage	2.03	0.00	11.65	2.97
DHS (%)	2.94	-	41.05	6.92

FROA, future return on assets; PROA, past return on assets; ROA, return on assets; CP, chairpersons; CEO, chief executive officers, PB, price to book ratio; IA, intangible assets, Revenue (ZAR billion), revenue in rand billions, DHS (%), director shareholding percentage. †, Past ROA is described as  $n-1$ , current year ROA is  $n$ , FROA is  $n+1$ .

## Descriptive statistical analysis

Table 1 displays the descriptive statistical analysis of the dependent, independent and control variables as discussed above.

The individual components of optimism reveal that, based on mean scores, the CPs' letters achieved higher scores than the CEOs' letters on rhetorical tones, Praise, Satisfaction, Blame, Hardship and Denial, whereas the CEOs' letters only achieved higher mean scores on Inspiration. This suggests that although the CPs' letters' rhetorical tone achieved higher scores in many of the positive subcomponents of optimism, the CPs utilised a balanced approach in their communication strategy

and also received higher scores in the negative subcomponents of optimism relative to the CEOs. This is supported by the CPs' letters achieving higher mean scores for both the PEG and NEG Score, as well as for the master variable Optimism. The balanced approach communication strategy of the CPs using both emotive positive and negative rhetorical tones suggests that the focus is on both positive and negative aspects of optimism, contrary to an expected focus on the positive aspects. For the CEOs, the findings suggest that the CEOs use less emotive positive and negative rhetorical tones in an attempt to perhaps discuss the results in a neutral tone.

**Research Question 1:** Is there any difference in the level of optimism displayed in CEOs' letters in comparison with CPs' letters?

The results of the ANOVA regarding the level of optimism in the CPs' letters and the CEOs' letters (main fixed effect) revealed that the CPs' letters were statistically significantly more optimistic (mean = 53.565) than the CEOs' letters (mean = 53.230) at the 5% or better level (Repeated measures ANOVA  $F [1343] = 4.47$   $p = 0.04$ ; eta-square = 0.01). This suggests that the CPs generally had a more optimistic rhetorical tone in their letters relative to their CEO counterparts. Although the CEOs and the CPs fulfil a similar role in terms of their agency with shareholders, the rhetorical tone in the CPs' letters seems to reflect a more optimistic tone on the same set of facts concerning the relevant financial year being reported on. On the analysis of the interaction between the mean optimism levels of the CPs' and CEOs' letters and the financial years, it is noted that the response variable, mean optimism levels do not differ significantly over time (Repeated measures ANOVA  $F [3343] = 0.31$   $p = 0.82$ ) suggesting the mean scores remain relatively constant over the sample period.

**Research Question 2:** Is the displayed optimism (as per its link to future performance) in the respective CEOs' and CPs' letters sincere?

Table 2 shows the results of the panel regression performed to answer Research Question 2. As discussed in the method section, this study interprets a positive association between the level of optimism and future performance as sincere. A negative relationship, including the absence of any statistically significant relationship, on the other hand, is interpreted as evidence of impression management.

The results in Table 2 show that, with respect to the CEOs' letters, the partial negative contribution (coefficient of  $-0.08$ ) of optimism in the presence of control variables is not statistically significant and therefore optimism neither predicts nor influences future performance (FROA). The negative association between optimism and future performance, however, shows evidence of insincerity and a proxy for impression management in support of the obfuscation hypothesis.

However, the findings related to the CPs' letters show a statistically significant association between optimism and FROA. Furthermore, the negative standard coefficient of  $-0.94$  for CPs' letters, which represents approximately 11.75 times the coefficient of CEOs' letters as shown in Table 2 suggests that optimism is significantly incongruent with FROA and evidence of insincerity and therefore impression management within the CPs' letters in support of the obfuscation hypothesis.

**Research Question 3:** Are there any differences in the level of sincerity between CEOs' and CPs' letters?

While the findings for both the CEOs' and CPs' letters show a negative association between optimism and future

**TABLE 2:** Regression results of optimism on future performance.

Variables	CEO	CP	POS CEO	POS CP	NEG CEO	NEG CP
	FROA	FROA	FROA	FROA	FROA	FROA
<i>n</i>	200	200	200	200	200	200
Optimism; POS; NEG	-0.08	-0.94***	-0.06	-0.27***	0.13	0.49
Activity	-0.2	0.15	-0.22	0.09	-0.19	0.14
Certainty	-0.27	0.04	-0.25	0.07	-0.29*	-0.03
Realism	0.32	0.56	0.33	0.56	0.32	0.14
Commonality	-0.19	1.03***	-0.21	1.00***	-0.17	0.86***
Past ROA	0.30**	0.29**	0.30*	0.30**	0.31**	0.30**
PB	-1.98**	-0.64	-1.97**	-0.64	-2.01**	-1.8*
IA to assets ratio	1.75	7.12	1.67	7.24	1.99	-2.59
Ln (total revenue)	0.54	-1.3	0.71	-1.49	0.51	1.54
Ln (number of employees)	-8.66**	-3.73	-8.69**	-3.67	-8.65**	-8.70*
Loss (dummy variable) ROA	4.97*	5.58*	4.96	5.41*	4.94*	6.23*
Ln (market capitalisation)	11.72***	10.75***	11.71***	10.57***	11.85***	11.99***
Leverage	5.62***	3.19*	5.49**	3.16*	5.88***	5.35**
DSH	0.04	0.05	0.05	0.04	0.03	0.11
<i>p</i> -value	0.00	0.00	0.00	0.00	0.00	0.00
<i>F</i> -value	3.01***	3.37***	3.03***	3.29***	3.02***	3.46***
<i>R</i> squared	0.29	0.31	0.29	0.30	0.29	0.32
Adjusted <i>R</i> squared	-0.10***	-0.04***	-0.09***	-0.09***	-0.05***	-0.05***

Note: FROA, Lead performance (ROA); One-way, One-way linear fixed effect regression; Two-way, Two-way linear fixed effect regression.

ROA, return on assets; CP, chairpersons; CEO, chief executive officers; PB, price to book ratio; DSH, directors' shareholding; Ln, natural logarithms; IA, intangible assets; POS, positive; NEG, negative. \*, at the 10% level; \*\*, at the 5% level; \*\*\*, denotes statistical significance at the 99% level.



performance, as evidence of insincerity, as a proxy for impression management and in support of the obfuscation hypothesis, it is noted that this association is only significant for the CPs' letters.

Opposite of what was expected, the results show that CPs are more likely to be insincere in their letters than CEOs. One possible reason is that CEOs may be more conservative to avoid criticism from analysts, institutional investors and shareholder activists, as they are presumably more visible given their assumed overall responsibility for the firm. The results, therefore, also disprove the prediction made by the agency theory that CPs' letters will be more sincere than CEOs' letters.

In light of the evidence of impression management within both CPs' and CEOs' letters several robustness tests were performed by investigating the statistical association between optimism's POS Score CEO/CP and FROA, as well as between optimism's NEG Score CEO/CP and FROA.

Consistent with the findings presented in Table 2, both the POS and the NEG components of CEOs' letters of optimism had no statistical association with FROA. This is supported by the finding that there is no statistically significant association between optimism and FROA in CEOs' letters in the South African reporting context.

For the CPs' letters, however, the results indicate a statistically significant and negative association between POS Score CP and FROA but a positive but not statistical association between NEG Score CP and FROA. The findings suggest that for the CPs' letters, optimism's positive component potentially creates the statistical association between optimism CP and FROA. The CPs' letters therefore appear to be relatively more positive in their narratives, which further supports the notion that the CPs' optimism appears to be statistically significantly incongruent with future performance as evidence of impression management.

## Conclusion

Using panel data from 50 JSE-listed companies over 4 financial years, this study aimed to compare the level of optimism between CEOs' and CPs letters (Research Question 1) and to test the obfuscation hypothesis as optimism displayed (as per its link to future performance) in CEOs' and CPs' letters in integrated annual reports and to compare the differences between them (Research Questions 2 and 3). It is noteworthy that although it is common practice to include both such letters in companies' integrated annual reports, the content is voluntary in the South African context, as is the case in many other countries. It is important to reemphasise the unique research setting provided by the study of JSE-listed companies, given the strength of corporate governance in South Africa, as a result of the King Code of Corporate Governance, of which one recommendation is the separation of the roles of the CEO and the CP (IoDSA, 2016).

Following previous research, a positive association between optimism (as the independent variable) and future performance (as the dependent variable) was interpreted as both sincere and indicative of the absence of impression management, with a negative association, on the other hand, as support for the obfuscation hypothesis and therefore impression management. Chief executive officers' and CPs' letters were obtained from published integrated annual reports, and DICTION was used to calculate an optimism score for each, which resulted in 200 optimism scores for each. Optimism, together with several control variables, was used in the regression analysis.

This study found that the CPs' letters were statistically significantly more optimistic than those of CEOs (Research Question 1). This should be interpreted against the results reported by Du Toit and Esterhuysen (2021), namely that substantiated optimism is a narrative style in JSE-listed companies' CEOs' letters, which is similar to their counterparts abroad. The findings for both the CEO and CP show a negative association between optimism and future performance, as evidence of impression management and in support of the obfuscation hypothesis (Research Question 2). It is noted, however, that this association is only significant for the CPs' letters; more specifically, optimism in the CPs' letters was found to be negatively and statistically significantly (at the 1% or better level) related to future performance (Research Question 3). One interpretation is that the CP, with inside knowledge of future performance, deliberately uses an optimistic writing style to mislead stakeholders.

Consistent with the results reported using the total optimism score, both the positive and the negative components of the score as calculated for the CEOs' letters showed neither positive nor significant associations with future performance. Although the negative component of the score calculated for the CPs' letters showed no statistical association with future performance, the positive score component showed both a statistically significant and a statistically negative association with future performance. This reinforces the support for impression management in the CPs' letters. Overall, the results indicate the CPs' letters to be relatively more insincere when compared to the CEOs' letters, which further rebuts our prediction as per agency theory of the CPs' letters sincerity relative to CEOs' letters.

Against the background of recent corporate scandals and fraud, the absence of sincerity or evidence of impression management can further impede stakeholders' trust in CEOs and CPs of companies. Although information through such narratives can potentially decrease agency costs, insincere narratives will arguably have the opposite effect. Possible reasons for this evaluated optimism in the CPs' letters, seemingly unsubstantiated in terms of future performance, include the absence of guidelines on the structure and content of such letters, assurance through an external audit, fear of lawsuits and stakeholders' level of education. Although preliminary evidence is provided – of which all integrated

annual report users and regulatory bodies such as the JSE and IoDSA should take note – this study's research design had limitations that warrant future research.

Since this study used only one data source, namely integrated annual reports, there is an opportunity for future research on the presence of optimism in other communication channels and forms of media such as Facebook and Twitter. Furthermore, the study failed to examine CEO and CP rotation, as well as managerial entrenchment, during the study period. The results may also be biased towards larger companies and the optimism score may have been subject to limitations, as pointed out by previous research. It is suggested that future studies could include other measures of board independence, such as the percentage of independent nonexecutive directors, a sample that aims to be more representative of listed companies, as well as other measures of optimism. Studies that separately compare CEOs' and CPs' letters in an impression management context using data from within an emerging economy are limited. Future studies could also include an analysis of the content of CEOs' and CPs' letters, as well as other narratives in integrated annual reports. Finally, an investigation into the relationship between impression management and earnings management may aid in an enhanced understanding of this phenomenon.

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## Data availability

The data that supports the findings of this study are available from the corresponding author SAF upon reasonable request.

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Appendix starts on the next page →

## Appendix 1

**TABLE 1-A1:** The list of 50 JSE-listed companies.

Number	Ticker	Firm name
1	ABG	Absa Group Limited
2	AFE	AECI Limited
3	AGL	Anglo American Plc
4	AMS	Anglo American Platinum Limited
5	ANG	AngloGold Ashanti Limited
6	APN	Aspen Pharmacare Holdings Limited
7	ARI	African Rainbow Minerals Limited
8	BAW	Barloworld Limited
9	BHP	Bhp Group Plc
10	BID	Bid Corporation Limited
11	BTI	British American Tob Plc
12	CCO	Capital & Counties Properties Plc
13	CLS	Clicks Group Limited
14	CML	Coronation Fund Managers Ltd
15	EPP	Epp N.V.
16	FSR	Firstrand Limited
17	GFI	Gold Fields Limited
18	GLN	Glencore Plc
19	HAR	Harmony Gold Mining Co. Limited
20	HMN	Hammerson Plc
21	IMP	Impala Platinum Holdings Limited
22	IPL	Imperial Logistics Limited
23	KAP	Kap Industrial Holdings Limited
24	LBH	Liberty Holdings Limited
25	LHC	Life Healthcare Group Holdings Limited
26	MEI	Mediclinic Int Plc
27	MRP	Mr Price Group Limited
28	MSM	Massmart Holdings Limited
29	MTM	Momentum Met Holdings Limited
30	NED	Nedbank Group Limited
31	NHM	Northam Platinum Limited
32	NTC	Netcare Limited
33	OMU	Old Mutual Limited
34	PIK	Pick n Pay Stores Limited
35	RBP	Royal Bafokeng Platinum
36	RDF	Redefine Properties Limited
37	REM	Remgro Limited
38	RMH	Rand Merchant Bank Holdings Limited
39	RMI	Rand Merchant Investment Holdings
40	S32	South32 Limited
41	SBK	Standard Bank Group Limited
42	SHP	Shoprite Holdings Limited
43	SPP	The Spar Group Limited
44	TBS	Tiger Brands Limited
45	TFG	The Foschini Group Limit
46	TKG	Telkom SA SOC Limited
47	TRU	Truworths International Limited
48	VKE	Vukile Property Fund Limited
49	VOD	Vodacom Group Limited
50	WHL	Woolworths Holdings Limited

Source: IRESS