MIRAGE

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Study sheds light on impact of sunshine on corporate decision-making

A Deakin University study has found business leaders are more optimistic about their company's profit outlook when the sun is shining, suggesting investors might want to check the weather forecast before making financial decisions.

In the first large-scale study of the nuanced ways in which emotions affect top executives, Deakin Business School's Associate Professor Edward Podolski analysed a large sample of earnings data from U.S. public firms to determine the role and economic consequences of the weather in shaping the judgment of corporate executives.

He found that managerial profit forecasts were highly sensitive to the average sunshine conditions in the days immediately before delivering earning reports, with executives tending to overstate future earnings when they were exposed to more sunshine and understate earnings when exposed to less sunshine.

While it is well accepted that top executives' personality traits, such as overconfidence, thrill-seeking or narcissism, affect their decisions, Associate Professor Podolski said this study is the first to show that emotional states also influence corporate decisions.

"The rationale goes back to a well-established link in neurobiology showing that sunshine exposure has a strong effect on an individual's mood," Associate Professor Podolski explained.

“It follows that if managerial emotions shape corporate decision-making, those decisions will fluctuate with the sunshine conditions that top executives are exposed to.

“Our study shows that corporations do not always make well-thought-out decisions which are exclusively aimed at maximising firm value. Instead corporate decisions are susceptible to fluctuations in managerial mood, which for all intents and purpose are random.

“Investors would therefore be well advised to take into account the weather conditions to determine the likely mood of top executives around the time when an important announcement or disclosure is made by the firm.”

The study, conducted with researchers from Monash University, City University of Hong Kong, Memorial University of Newfoundland and TA Pai Management Institute, also found that emotions do not affect the judgement of top executives uniformly, with the effect that sunshine-induced mood had on corporate decisions dependent on context.

“Top executives appear to be more influenced by their mood when making decisions in a more uncertain environment, such as when they are subject to lax external oversight from the news media, regulators, and their shareholders, and when they have few incentives to make decisions unbiased by mood,” Associate Professor Podolski said.

“Interestingly, we found that top executives working in settings which make it easier for emotional biases to seep into the decision-making process impose costs on their shareholders in the form of higher financing costs, as well as on themselves, in the form of poorer career progression.

“Specifically, those CEOs who have a history of being susceptible to the sunshine-priming effect experience higher turnover, lower average pay, and fewer appointments as CEOs.

“It would therefore appear that external discipline placed on managers not only helps firms’ shareholders but is good for managers in the long-run.”

Associate Professor Podolski said that more stringent external oversight by regulators, shareholders, and other stakeholders helped eradicate the effect of changes in emotions in the decision-making process.

“Factors which inhibit top executives from relying on their emotions appear to not only improve the firm’s ability to maximise value but is also beneficial for the executives’ career prospects,” he said.

The study, ‘Emotions and Managerial Judgement: Evidence from Sunshine Exposure’, is published online in the international journal The Accounting Review.