AFAANZ Grant Report 2017-2018

1. Applicant:

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2. Project Title:

When Does Reputation Matter? Evidence from Analysts' Reliance on Management Guidance

3. Updated Project Summary:

One working paper was generated from this project, which is now named as "When does analyst reputation matter? Evidence from analysts' reliance on management guidance." The development of this project resulted in a collaboration with two co-authors, Professor Hun-Tong Tan and Dr Wei Chen. Professor Tan from Nanyang Technological University is a leading accounting researcher in the world (ranked at #6 according to BYU Accounting Author Ranking, and Editor of Accounting, Organizations and Society). Dr Chen is a Senior Lecturer in Accounting at UNSW, who has published papers in the Journal of Accounting Research, Accounting, Organizations and Society, and Auditing: A Journal of Practice & Theory.

Our sample is constructed based on quarterly analyst forecasts obtained from the I/B/E/S database, and quarterly management guidance obtained from the First Call database, including 164,963 guidance-forecast observations for the period from 1994 to 2011. Reputable analysts are All-America analysts nominated by the Institutional Investor Magazine. We find that reputable analysts tend to rely less on management guidance when they issue their forecasts. More importantly, this reputation effect is more pronounced when there are greater opportunities for reputable analysts to exert their superiority in supplying incremental information; i.e., when prior analyst forecast dispersion is greater, or when guidance contains good news. The results are invariant to a battery of robustness tests. Next, we investigate the costs and benefits of this reliance on guidance. The results suggest that reputable and less reputable analysts bear similar costs for being less accurate when they rely less on management guidance. However, reputable analysts enjoy more benefits in terms of stronger market reactions to their forecasts when they rely less on management guidance.

Our paper contributes to three related streams of literature. First, we contribute to the literature by investigating whether and when reputable analysts provide informative earnings forecasts. Investigating this individual analyst reputation effect is important because when managers are incentivized to engage in expectation management, reputable analysts are among the most prominent targets, given that they have stronger market influences and their forecasts are the key benchmarks for managers to meet or beat. Second, we add to the literature on analyst reputation. We find that the analyst reputation effect is stronger when information uncertainty is higher, or when management guidance contains good news (low credibility). These results suggest a benefit to investors when they rely on analyst reputation as a cue for quality. Specifically, investor reliance is well placed, particularly in situations where they most need analysts' expertise (i.e., when there is high information uncertainty or low guidance credibility). Finally, our study can also be placed within a broader lens in terms of understanding how analysts' forecasts deviate from a publicly-available market benchmark. Our study extends our knowledge beyond the literature on analysts' herding behaviour in that reliance on management guidance and herding toward peers' consensus are two distinct constructs, and therefore the extrapolations from analyst herding behaviour do not necessarily apply in our setting.

4. Funds Granted:

$5,000

5. Detailed Report on Expenditure of Funds against Budget Items, with variations explained:

A. Research Visits: The budget for this item is $2,400. The actual expense is $4,130 because I took two research visits rather than one visit as proposed in the grant application. Face to face discussion with the co-author was really helpful in clearing the issues during the research process and strengthening the quality of our project.

B. Maintenance Budget: The budget for this item regarding journal submission is $700 and the actual expense is $0. The future journal submission fee of the working paper will be covered by other funding.

C. Personnel (Research Assistant Salaries): The remaining budget for data collection is $1,900 (5,000-2,400-700) and the actual spending is $870 because we find a well-qualified research assistant who can help us collect the data effectively.

6. Outcomes:

Working Paper – "When does analyst reputation matter? Evidence from analysts' reliance on management guidance", co-authored with Hun-Tong Tan and Wei Chen (please refer to the attachment for the working paper).

Abstract: We investigate the role of analyst personal reputation in providing informative earnings forecasts through less reliance on management earnings guidance and the conditions under which this occurs. We find that, compared to less reputable analysts, reputable analysts rely less on guidance when they issue earnings forecasts. This analyst reputation effect is stronger when information uncertainty is higher, or when the guidance contains good news. Further analysis suggests that both reputable and less reputable analysts sacrifice their forecast accuracy when they rely less on guidance. However, reputable analysts are compensated to a greater extent by the increased informativeness of their forecasts.

7. Future Intentions for this Project:

A. Conference submission: We intend to submit the working paper to AFAANZ annual conference and other domestic and international conferences to receive helpful comments and suggestions.

B. Journal submission: We plan to submit the paper to leading journals such as Accounting, Organizations and Society, and Journal of Business Ethics.

C. Grant application: Professor Hun-Tong Tan and Dr Wei Chen have agreed to join me to apply for the ARC Discovery Project 2020 with regard to a project about the association between social media and analyst behaviour, for which the research idea was developed from this AFAANZ project.

D. Project: A future project spinning off from this grant will be examining the impacts of analyst reliance behaviour on analysts' future career prospects and management strategic disclosures. We conjecture that analysts' career will be more advanced if they rely less on guidance and provide more independent reports, and managers will less likely make strategic disclosures to mislead the markets when they find reputable analysts tend to correct their disclosure biases in the past.

8. Summary of Outcomes and Benefits:

Overall, I view the outcomes of the AFAANZ Grant being very successful. The grant generated one working paper and one future project, both with the potential of being published in leading journals and adding to the knowledge in accounting and finance professions. It also established my research collaborations with my colleague in UNSW (Dr Wei Chen) and with senior international leading accounting scholar (Professor Hun-Tong Tan). In the end, this AFAANZ Research Grant encouraged my future ARC Grant Application working with both collaborators from the grant.