


Andreas Krause

A wide-angle photograph of a city skyline viewed from across a body of water. In the foreground, the water is dark blue with gentle ripples. A low concrete wall separates the water from a row of buildings. On the left, there are several multi-story brick buildings with traditional architectural features like gables and dormers. To the right, a long, low-profile modern building with a dark roof and large windows stretches across the frame. Behind these buildings, a dense cluster of modern skyscrapers rises against a clear, light blue sky. The skyscrapers vary in height and design, including cylindrical towers and rectangular structures with glass facades. A construction crane is visible on the far right side of the skyline.

Financial analysts

Positive analyst coverage

- ▶ Financial analysts provide an assessment of the future prospects of securities for investors
- ▶ These recommendations are overall overly positive
- ▶ It is common to attribute this apparent bias to a desire by investment banks to attract future business from companies
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Further explanations for positively biased analyst recommendations

- ▶ Many behavioural explanations have been offered. For example a cognitive bias where analysts are not sufficiently critical of companies
- ▶ Investment banks and individual analysts selecting which companies to cover will select those they are most positive about
- ▶ Financial analysts might only obtain access to information if they are reporting positively about a company

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Access to information

- ▶ Financial analysts are not only using publicly available information to compile their reports and recommendations
- ▶ Access to senior managers at analyst conferences and the ability to interact with them provides additional insights
- ▶ Companies prefer positive coverage, so might be more willing to enable access to financial analysts with positive recommendations
- ▶ We will explore how such privileged access can be optimal, even if a bias in the recommendation is required

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Chapter 8.1
Financial analyst access to company information

Discussion of the model results

- Financial analysts publish overly positive recommendation with the aim of getting access to information
- Despite the bias, analyst recommendations are better due to access to additional information
 - Regulation requires that information is disclosed equally and publicly, how can companies provide better access to some investment banks?
 - Soft information can be gained through personal interactions; information might also be obtained on how confident managers are about their future prospects

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Companies seeking positive coverage

- ❑ Providing analyst coverage and selling their reports is not profitable to investment banks
- ❑ Analyst coverage is often provided as part of the agreement after the issue of securities
- ❑ Analyst coverage also allows contact to the senior management of companies with the aim to secure future business
- ❑ Companies are more likely to seek advice from investment banks that see them positively

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Chapter 8.2
Obtaining future investment banking business

Discussion of the model results

- In order to gain future business from clients, investment banks publish positively biased analyst reports
- This bias is limited by the effect it has on the value analyst reports have to investors
 - Apart from profitability concerns, could investment banks bias their analyst reports as much as they want?
 - If analyst reports are too biased, they will lose credibility and investors will not trust that companies have been advised well

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Preventing biased analyst reports

- Financial analysts are regulated with the aim to improve the quality of their reports
- As they bias their reports such that investment banks can attract income from clients, their remuneration is supposed to be unaffected by such income
- Focussing solely on the accuracy of their reports is supposed to eliminate this bias
- We will investigate whether such regulation is effective⁶⁻ⁱ

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Chapter 10
Regulation of financial analysts

Discussion of the model results

- ▶ Chinese Walls are ineffective as investment banks can set benchmark salaries that indirectly reward biased reports
- ▶ Information on analyst quality is more likely to be effective provided companies prefer investment banks that have high-quality analysts
 - Is remuneration the only motivation for analysts to provide biased or unbiased reports?
 - ▶ An analyst refusing to publish biased reports that benefit the investment bank may find it difficult to retain his job and competitors will also unlikely seek to employ him

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Summary of key results

- Financial analysts are important in attracting additional business to investment banks since positive bias in recommendations is good for the bank
- This bias can be limited if information on the quality of analyst forecasts is available and companies seek investment banks with strong analysts
- Regulatory efforts of severing the link between gaining investment banking business and analyst remuneration are not effective

Summary of key results

- ▶ Financial analysts are important in **attracting additional business** to investment banks and a positive bias in recommendations is used to this end
 - ✦ This bias can be limited if information on the quality of analyst forecasts is available and companies seek relationships with strong analysts
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