



Stock price synchronicity and analyst coverage in emerging markets[☆]

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Abstract

This paper examines the relation between the stock price synchronicity and analyst activity in emerging markets. Contrary to the conventional wisdom that security analysts specialize in the production of firm-specific information, we find that securities which are covered by more analysts incorporate greater (lesser) market-wide (firm-specific) information. Using the R^2 statistics of the market model as a measure of synchronicity of stock price movement, we find that greater analyst coverage increases stock price synchronicity. Furthermore, after controlling for the influence of firm size on the lead–lag relation, we find that the returns of high analyst-following portfolio lead returns of low analyst-following portfolio more than vice versa. We also find that the aggregate change in the earnings forecasts in a high analyst-following portfolio affects the aggregate returns of the portfolio itself as well as those of the low analyst-following portfolio, whereas the aggregate change in the earnings forecasts of the low analyst-following portfolio have no predictive ability. Finally, when the

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forecast dispersion is high, the effect of analyst coverage on stock price synchronicity is reduced.
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1. Introduction

This paper investigates the informational role of security analysts in a number of emerging markets. We collect information from I/B/E/S International on analyst activity and examine whether analysts help generate market-wide or firm-specific information.

Our paper is motivated by the finding in [Morck et al. \(2000\)](#) that stock prices move together more in emerging markets than in developed markets, which suggests that less firm-specific information is produced in emerging markets. Their interpretation is that in emerging markets, weak property rights discourage informed trading and therefore prevent firm-specific information from being incorporated into stock prices. In addition, the recent financial crisis in Asia and other emerging markets shows that the dissemination of firm-specific information to public investors is inadequate. This lack of firm-specific information in emerging markets can be attributed to a number of factors. First, there is little enforcement of the few regulations that relate to information disclosure in the emerging markets. Second, there is a low degree of voluntary disclosure and corporate transparency. Third, many companies in emerging markets are group affiliated or family owned, and it is difficult to collect reliable information on such companies.

The above facts raise important questions about the role of security analysts in the information production process in emerging markets. The incentive of security analysts to collect private information about individual companies has been discussed in many theoretical papers ([Admati and Pfleiderer, 1986](#); [Diamond and Verrecchia, 1981](#); [Grossman and Stiglitz, 1980](#)). Empirically, a number of papers present evidence on the role of analysts in the U.S. market ([Brown, 1978](#); [O' Brien, 1988](#); [O' Brien and Bhushan, 1990](#)). However, few of these studies examine analyst activity in emerging markets, where the incentives to collect information might be different from those in developed markets. An exception is [Chang et al. \(2001\)](#), who examine analyst activity around the world, including in a number of emerging markets. They show that country-specific variables influence both the extent of analyst activity and the accuracy of analyst forecasts. They also show that in emerging markets, the earnings of business groups are more difficult to forecast than the earnings of nonbusiness groups.

An important but unexplored issue is the nature of the information that is produced by security analysts. In particular, although the availability of firm-specific information is shown to affect external financing and the efficiency of capital markets ([Durnev et al., 2003a,b](#)), the role of security analysts in producing firm-specific information in emerging markets is unclear. As information intermediaries who issue earnings forecasts of individual companies, security analysts specialize in the production of firm-specific information. However, [Piotroski and Roulstone \(2004\)](#) find that in the U.S., although the presence of insiders and large institutional investors has the effect of increasing the amount of firm-specific information that is incorporated into stock prices, security analysts

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