Impact of strategy on analyst information

Ozer Asdemir a, Guy D Fernando b, Richard A. Schneible Jr c,*, Arindam Tripathy d

a Opus College of Business, University of St Thomas, St Paul, MN 55105, United States
b School of Business, State University of New York, 1400, Washington Ave, Albany, NY 12222, United States
c College of Business, University at Albany, Albany, NY 12222, United States
d Milgard School of Business, University of Washington – Tacoma, Tacoma, WA 98402, United States

A R T I C L E   I N F O

Article history:
Received 22 June 2016
Received in revised form 20 December 2016
Accepted 22 December 2016
Available online 9 January 2017

A B S T R A C T

In this paper, we investigate the impact of firm strategy on the properties of analyst’s information. We argue that analysts’ total information (common and idiosyncratic information together) about a firm depends on how clearly evident the chosen strategy of a firm is. Second, we argue that financial analysts will see more opportunities for value addition in differentiators, and hence, will gravitate more towards such firms. Analysts add value by gathering private information and, thus, individual analyst’s private information will be a greater percentage of total information for a firm pursuing a differentiation strategy than for a firm pursuing a cost leadership strategy. Our results confirm our hypotheses.

© 2016 Elsevier Ltd. All rights reserved.

1. Introduction

In this paper, we investigate the impact of firm strategy on the properties of analysts’ information. Analysts’ information, reflected in their forecasts, is a mix of the common (or public) information available to all analysts and the idiosyncratic (or private) information gathered by individual analysts. We argue that as the strategies followed by firms become more clearly evident, analysts’ total information (common and idiosyncratic information together) improves. The complexity of a firm’s business will depend greatly on its strategy, as will the accounting treatment of a firm’s operations. Therefore, we argue that the improvement in analysts’ total information arises in different ways depending on the particular strategy followed by a firm. A differentiation strategy relies on innovative products and branding, and this is associated with more intangible assets, uncertain cash flows, greater information asymmetry, and accounting rules that create greater mismatch between revenues and expenses. Thus, analysts following a differentiator will have to generate more private information. On the other hand, a firm following a cost leadership strategy has more fixed assets, and accounting rules provide for a better match between revenues and expenses. Hence, there is more public information available for cost leaders. Therefore, the individual analyst’s private information will be a greater percentage of total information for a firm following a differentiation strategy and a smaller percentage for a firm following a cost leadership strategy. Our results confirm our hypotheses and show that the analysts’ total information improves as the strategy followed by a firm becomes clearer, but that improvement is due to an improvement in common information of analysts following cost leaders; whereas it is due to an improvement in idiosyncratic information of analysts following differentiators.

Firm decisions regarding investing and operating activities are determined by the strategy the firm adopts. Porter (1980) suggests that profit maximization can be accomplished by being the lowest cost producer in an industry (cost leadership strategy), or by developing some point of differentiation which will enable the firm to charge higher prices than its competitors (differentiation strategy). Firm strategy is chosen early on in the life of the firm. Commitment to a particular strategy involves a substantial investment in physical, financial, and intellectual capital; hence firm strategy remains comparatively steady over time (Snow & Hambrick, 1980; Bentley, Omer, & Twedt, 2013). Therefore, being a fundamental and constant characteristic of a firm, firm strategy becomes an important determinant of the firm’s information environment (Bentley et al., 2013) while providing a unique means of assessing the same.

In addition to the type of strategy followed by the firm, the extent to which a firm’s strategy is clearly evident will also affect analysts’ information. If a firm has a clearly defined and communicated strategy, it will provide a framework for analysts to evaluate and process new information. Thus, a firm’s commitment to a clearly evident strategy should improve analysts’ total information.

The information environment of a firm is a joint function of the firm’s strategy, the investment decisions made by firms in the pursuit of that strategy, financial accounting rules, voluntary disclosures, and coverage by information intermediaries (Fernando, Schneible, & Tripathy, 2016). Firms pursuing a differentiation strategy make investments in more intangible assets and have expected cash flows with

http://dx.doi.org/10.1016/j.adiac.2016.12.003
0882-6110/© 2016 Elsevier Ltd. All rights reserved.
higher uncertainty, resulting in greater information asymmetry (e.g., Himmelberg & Petersen, 1994; Aboody & Lev, 2000; Barth, Kaznik, & McNichols, 2001; Boone & Raman, 2001). In addition, financial accounting rules for intangibles which create a mismatch between expenses and the revenues that they generate may lead to greater information asymmetry (Lev & Zarowin, 1999). Furthermore, Asdemit, Fernando, and Tripathy (2013) and Fernando et al. (2016) show that the earnings of differentiators are more complex resulting in financial markets taking a longer time to fully assimilate information contained in their earnings.

However, more financial analysts tend to follow firms with poorer information environments where their intermediation adds more value. Research shows that firms that may have an intrinsically poorer information environment due to significant investments in intangibles such as R&D and advertising attract more analysts (Barth et al., 2001; Lehavy, Li, & Merkley, 2011; Lobo, Song, & Stanford, 2012). In many settings, analysts’ forecasts have demonstrated superiority to those from time-series models because analysts have the ability to gather private information (Kothari, 2001; Healy & Palepu, 2001). Therefore, we argue that more financial analysts will follow differentiators compared to cost leaders due to a greater ability to add value from private information gathering. We also argue that since there is a greater incentive to gather private information about differentiators, analysts will have more idiosyncratic information about these firms compared to cost leaders.

In this paper, we first examine the relation between analysts’ total information and the degree to which a firm’s strategy is clearly evident. Next, we examine the relation between the particular strategy followed by a firm and analysts’ following. Finally, we examine the relation between the particular strategy followed by a firm and the proportion of common to idiosyncratic information in analysts’ information.

We use a measure of the total amount of, as well as the relative amounts of, common and idiosyncratic components of total information suggested in Barron, Kim, Lim, and Stevens (1998), (hereafter BKLS). We relate these measures of the properties of analyst information to Balsam, Fernando, and Tripathy’s (2011) two-dimensional mapping of firm strategy, which in turn is based on the generic strategy framework posited by Porter (1980).

Using two measures of analysts’ total information, mean forecast error and uncertainty (BKLS), we find that the degree to which a firm’s strategy is clearly evident is directly proportional to measures of analysts’ total information, supporting our first hypothesis. Next, and consistent with our second hypothesis, we find that more analysts follow firms that pursue a differentiation strategy compared to those that follow a cost leadership strategy. Finally, our results also confirm our third hypothesis by showing that, compared to cost leaders, firms that follow a differentiation strategy have less consensus among analysts, indicating greater idiosyncratic information.

Our study makes several contributions to existing literature. First, we add to the extant literature (Asdemit et al., 2013; Fernando et al., 2016) on the effect of firm strategy on analysts’ information by showing that strategic clarity improves analyst information while the choice of strategy affects the relative amount of private information gathered by analysts. Second, we highlight the effect of firm strategy on the analysts’ choice to follow a firm. Our results also highlight the value of multiple analysts following of a particular firm and the aggregation of forecasts from those analysts in improving the information environment of a firm. Finally, we show another aspect of a firm that is impacted by its strategy and show the usefulness of accounting based measures in identifying such strategy (Balsam et al., 2011; Asdemit et al., 2013; Schneible, 2015).

The rest of the article is structured as follows. Section 2 provides the literature review and hypotheses development, while Section 3 discusses the research methodology and data. Section 4 discusses the results and Section 5 concludes.
دریافت فوری متن کامل مقاله

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات