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Ownership structure and forecast accuracy in Spain

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ABSTRACT

This article examines how analysts respond to specific ownership structure characteristics by studying the accuracy of their forecasts after the release of the first Spanish corporate governance code and before IFRS were adopted. Specifically, we analyse the influence of ownership concentration, bank ownership and insider ownership on analyst forecast errors. Overall the results show a positive and significant influence of bank ownership on analyst forecast accuracy, which suggests that bank ownership leads to closer monitoring of management and a reduction in analyst forecast errors. However, the presence of large shareholders and insiders in the ownership structure of the firm does not significantly affect the accuracy of financial analysts. This research provides investors with a more refined sense of how analyst forecasts might be affected through the composition of the ownership structure in a context of high concentration of ownership, relevant presence of banks in firms as creditors and shareholders, and local GAAP.

1. Introduction

We examine whether, after the release of the first Spanish corporate governance code, ownership structure influences analyst forecast accuracy for Spanish firms. We examine this association in a context where the accounting standards were local GAAP and the main characteristics of the corporate governance system were high concentration of ownership and important presence of banks in firms as creditors and as shareholders. We show that, under this situation, bank shareholding is the main ownership mechanism that reduces analyst forecast errors.

Many authors have provided evidence that certain factors appear to influence the quality of financial analysts' information. The negative association between analyst forecast error and corporate size, and the positive association with forecast horizon are well documented in the literature, suggesting that analyst forecasts are more accurate for larger firms and for forecasts issued closer to the time of earnings announcement (e.g. Brown, Richardson, & Schwager, 1987; Duru & Reeb, 2002; García-Meca & Sánchez Ballesta, 2006; Lang, Lins, & Miller, 2003; Lang & Lundholm, 1996; Lys & Soo, 1995).

The specific characteristics of corporate governance mechanisms (included as recommendations in most corporate governance codes), are intended to enhance monitoring quality, reduce the benefits to managers of withholding information, and hence, increase firm transparency. Although corporate governance is closely related to the integrity of the financial information, and financial reporting quality is associated with analysts' forecast accuracy, the association between corporate governance mechanisms and analyst forecasts has been less explored (Ackert & Athanassakos, 2003; Ahmad-Zaluki & Wan-Hussin, 2010). While most studies have focused on the association between corporate governance quality and firms' mandatory and voluntary disclosures (e.g. Eng & Mak, 2003; Karamanaou & Vafeas, 2005), this study differs in motivation.

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We examine the association between corporate governance mechanisms and the quality of earnings information from a user's perspective. Financial analysts are considered among the most important and influential users of financial reports and among the most important information intermediaries between firms and investors.

The main aim of this research is to analyse whether analysts are able to take into account one special corporate governance characteristic, ownership structure, in their forecasting activity. Specifically, we analyse the impact of different dimensions of this corporate mechanism – bank shareholding, insider ownership, and ownership concentration – on the quality of the information provided by financial analysts, measured by the accuracy of their forecasts.

The influence that governance mechanisms exert on the extent and consequences of the agency problem, points to an association between the quality of analysts' reports and ownership structure variables. Hence, we hypothesize that ownership structure may promote effective decision making and reduce information asymmetry and moral hazard, thus lowering the analyst forecast errors, mainly by increasing the external monitoring of management and by increasing the alignment incentive between minority and large shareholders

Past research has examined the association between ownership structure mechanisms and financial analysts. Ackert and Athanassakos (2003) found that analysts have incentives to issue optimistic forecasts when institutional ownership is high, and Parkash, Dhaliwal, and Salatka (1995) noted that ownership concentration positively influences forecast errors. Previous research has also demonstrated that more analysts follow firms with significant institutional interests (Ackert & Athanassakos, 2003; Bhushan, 1989). Recently, in Malaysia, Ahmad-Zaluki and Wan-Hussin (2010) found that a higher percentage of non-executive directors in audit committees is associated with greater forecast accuracy. Yu (2010), using a sample of 1228 companies from 36 countries and after controlling for firm-level and country-level differences, found that analyst forecast accuracy (analyst forecast dispersion) is positively (negatively) associated with the quantity of governance disclosures as measured by the transparency and disclosure ranking score.

We test whether the empirical results obtained in the US and UK markets also hold in a different institutional and regulatory framework. In this sense, Leuz, Nanda, and Wysocki (2003) reported that firms in countries with developed equity markets, dispersed ownership structures, strong investor rights and legal enforcement engage in less earnings management, suggesting differences in the link between corporate governance and the quality of reported earnings across countries. Similarly, Bhat, Hope, and Kang (2006) investigated whether corporate governance information impacts on the accuracy of earnings forecasts in a different way through different countries and found evidence that governance transparency took on increased importance in jurisdictions with poor legal enforcement. Their evidence suggested that the significance of governance transparency on analyst forecast accuracy is higher when legal enforcement is weak.

Very limited research on this topic has been carried out in non-Anglo-Saxon countries. Only Boubaker and Labégorre (2008) investigated the effects of some characteristics of the French corporate governance model on the number of analysts following firms during the period 1999–2000. The results showed that analysts are more likely to follow firms with a high discrepancy level between ownership and control and those controlled through pyramiding.

We focus on Spain, which presents important peculiarities as compared to Anglo-Saxon economies. Spain is a typical civil law country, with concentration of ownership in the hands of a few large blockholders who are influential in organisational behaviour (De Miguel, Pindado, & De la Torre, 2004). Hence, the agency conflict shifts from between principal and agent (Anglo-Saxon firms) to between large shareholders and minority shareholders. According to La Porta, Lopez de Silanes, and Shleifer (1999), in Spain the three largest shareholders hold 51% of the total shares, while in the US and UK this proportion is 20% and 19%, respectively. In Spain banks have traditionally maintained a large presence in firms, not only as creditors but also as controlling shareholders. In a market based system, firms are subject to internal monitoring (e.g., board) as well as external market discipline (e.g., market for corporate control), which is almost absent in Spain. Internal discipline by financial institutions and large shareholders are central to Spain's corporate governance. Spain is deemed not to shield minority shareholders adequately due to its weak legal protection rules and to its weak law enforcement system (La Porta et al., 1999). Analyst forecasts in this context may act as a valuable monitoring device. The lower level of capital market development, the existence of pyramidal groups, which means that the largest stake in listed and unlisted companies is held by other non-financial or holding companies, the existence of nonvoting shares, and the low activism of the takeover market are other specific characteristics of the Spanish corporate governance system (De Miguel et al., 2004).

Given the specific corporate governance in Spanish listed firms, this study focuses on ownership structure variables that are likely to be more powerful in the Spanish setting than in a U.S. setting, where crossed shareholdings are not important and shares are mainly in the hands of individuals directly or through institutional investors. We focus on three characteristics of a firm's ownership structure that we consider the most visible to Spanish stakeholders: degree of ownership concentration in the hands of the largest shareholders, ownership in the hands of directors and bank ownership.

Because we focus on a sample of Spanish non-financial listed companies on the Madrid Stock Exchange during 1999–2002, the data analysed dates back to a period that is prior to recent changes. In line with the European Commission (EC) Regulation 1606/2002, since January 1, 2005 listed companies in Spain have been required to prepare consolidated accounts following International Financial Reporting Standards (IFRSs). Moreover, with the development of the Spanish capital market, many efforts have been made to improve its market transparency and corporate governance. The Spanish path on Corporate Governance, started in 1998 with The Olivencia Report, which included the analysis of problems affecting Spanish stock companies, whose remedies should be settled, and an Ethical Code of Good Governance, which summarizes some recommendations. The Code sought to improve the governance of Spanish listed firms, but had neither statutory nor regulatory status. Some years later, in 2002, The Aldama Report followed the line of the Olivencia Code, essentially endorsing the philosophy of the rule of