Firms with high analyst coverage engage in excessive external financing and capital spending

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A new study in the journal *Financial Management* explored whether abnormal analyst coverage influences the extent to which companies raise funds from external sources (e.g., issue bonds or sell stock) and the amount of new investments firms decide to undertake.

John A. Doukas, Chansog Francis Kim, and Christos Pantzalis reviewed data on firms between 1980 and 2003 and used industry-adjusted metrics to measure excess analyst coverage.

Researchers found that abnormal analyst coverage plays an important role in explaining the firm's external financing and capital spending. Results show that firms with high analyst coverage consistently engage in higher external financing than do their industry peers of similar size. Additionally, firms with high analyst coverage tend to have higher levels of investment than do firms with low analyst coverage.

They also find that firms with high analyst coverage, external financing, and capital spending realize lower future returns than do firms with low analyst coverage, external financing, and capital spending. They argue that this evidence suggests that the impact of analysts on a firm's external financing and investment stems from excessive analyst coverage, which is a result of analysts' self-interest and pressure to promote investment-banking transactions.

The authors conclude that their analysis shows that excessive coverage "tends to enhance the credibility of the information generated by analysts, which affects the investment decisions of existing and new investors."

Source: Wiley

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