Sell-side analysts lean towards high valuation companies for comparison, study shows

April 30 2014

Ole-Kristian Hope is the Deloitte Professor of Accounting and the PhD Coordinator in Accounting at the Rotman School of Management. He has broad research interests in financial disclosure, financial reporting quality, corporate governance, analysts, valuation, auditing, private firms, corporate finance, and international business issues. He has published extensively in *The Accounting Review, Journal of Accounting Research, Journal of Accounting and Economics, Accounting, Organizations, and Society, Contemporary Accounting Research, Review of Accounting Studies*, and several other journals including *JIBS, JAPP, JBFA, JAAF, AH,* etc. Credit: Rotman School

Sell-side analysts lean towards high valuation companies for comparison, Rotman study shows.

Toronto – Brokerage-based analysts have a tendency to benchmark companies they are researching against others in the same category whose stock is already expensively-priced, shows a study from the University of Toronto's Rotman School of Management.

The result is that the company being researched may look undervalued and a good buy compared to the high valuation company. The finding provides some support for the idea that sell-side analysts choose "peer" companies strategically, in order to make their recommendations seem more credible.

Nevertheless, most analysts use reasonable criteria for picking peer companies, says one of the study's researchers.

"We believe these analysts fulfil an important function in the market. That doesn't mean they're perfect," said Prof. Ole-Kristian Hope, Deloitte Professor of Accounting at the Rotman School. Prof. Hope co-wrote the study with Gus De Franco, an associate professor of accounting at the Rotman School and Stephannie Larocque, a Rotman PhD graduate who is now an assistant professor of accounting at the University of Notre Dame.

The study also found that analysts show an even greater tendency to choose high valuation peer firms when their own brokerages have investment-banking affiliations with the companies they are researching.

The effect is less evident among analysts with an established reputation for skilled analyses.

Previous research has shown that reports by sell-side analysts tend to be optimistic. But this is the first large-scale academic study to examine what goes into those reports and how sell-side analysts decide which peer companies to use for their comparisons.

The study is forthcoming in the *Review of Accounting Studies*.

Provided by University of Toronto