

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

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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

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