



## Analyst coverage: Does the listing location really matter?



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### ABSTRACT

Using a count panel regression method, we find that the listing location really does matter as stocks listed on the main board (FTSE350) rather than the junior market (AIM) attract more analyst coverage than can be explained by existing factors, even when we control for listing requirements and the type of cross-listing. We also find that listing requirements have a significantly greater impact on the number of analysts following AIM companies rather than their FTSE350 counterparts. Moreover, pooling stocks from different listing locations can conceal additional differences in the determinates of analyst services for the main board and junior markets. For example, cross-listing on a stock exchange increases analysts coverage for FTSE350 stocks but not AIM stocks and listing on less transparent trading venues such as over the counter and alternative trading systems (dark pools) decreases analyst coverage, especially for AIM stocks.

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### 1. Introduction

It is crucial for managers to understand what influences analyst coverage since it is well documented that analyst coverage affects firm value. For example, Doukas, McKnigh, and Pantzalis (2005) and Jung, Sun, and Yang (2012) suggest that financial analysts facilitate more effective monitoring of the firms' activities, thereby reducing agency costs and increasing share value. Moreover, Baik, Kang, and Morton (2010) and Gotti, Han, Higgs, and Kang (2012) show that more analysts following increases firm value and reduces audit fees. In addition, Lang, Lins, and Maffett (2012) document higher liquidity and lower transaction costs when the number of analysts following a firm is higher. Li and You (2015) find that analysts create value for the firms they cover by increasing the demand for their common shares rather than monitoring or reducing information asymmetry.

Evidently, analyst coverage adds value to firms by signalling information about their performance and by increasing their visibility to investors, even when they do not actively add new information about these firms, but simply use existing information (Mola, Rau, & Khorana, 2013). Therefore, analyst coverage is actively pursued by

firms. For example, Anantharaman and Zhang (2011) provide evidence that managers value analyst coverage and are willing to expend resources to maintain a certain level of that coverage while Cliff and Denis (2004) find that firms are willing to compensate for analyst coverage through initial public offering premiums. Bushee and Miller (2012) note that some firms may resort to hiring investor relations professionals in order to pitch their business to security analysts while Kirk (2011) states that firms are prepared to buy research. Sibilkov, Straska, and Waller (2013) find that firms value analyst coverage and are prepared to strategically use the choice of merger and acquisition advisors to secure analyst coverage. Unsurprisingly, prior studies have tried to explore factors that drive analyst coverage, but mainly for the US market.

Our contribution is to highlight the influence of the marketplace for a company's shares on analyst coverage. Specifically, we examine the impact of three related aspects of listings on capital markets on analyst coverage. First, we examine whether listing on the main board (FTSE350) as opposed to the junior market (AIM) impacts the number of analysts following a stock. Second, we investigate whether the type of cross-listing such as listing on a stock exchange (SE), over the counter market (OTC) and alternative trading system (ATS) or "dark pools" is related to analyst coverage. Third, we examine whether listing requirements affects the number of analysts following a stock.

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Bhushan (1989) introduces a simple model where he suggests a number of firm characteristics that can impact analyst coverage. Following Bhushan (1989), subsequent empirical studies investigate the determinants of analyst coverage at both the country and firm levels. Multi-country studies examine the impact of different institutional environments on analyst coverage, such as investor protection, corporate governance (e.g., Baik et al., 2010; Boubakri & Bouslimi, 2010; Bushman, Piotroski, & Smith, 2004; Lang, Lins, & Miller, 2004; Yu, 2010), and the effect of varying accounting standards for cross-listed stocks (e.g., Abdallah, Abdallah, & Ismail, 2012; Chen, Weiss, & Zheng, 2007). In firm-level studies, scholars examine the impact of different company characteristics and corporate governance issues on analyst following (e.g., Baik et al., 2010; Barth, Kasznik, & McNichols, 2001; Bhushan, 1989; Brennan & Hughes, 1991; Eng, Nabar, & Mian, 2008; Jiraporn, Chintrakarn, & Kim, 2012; Jiraporn, Liu, & Kim, 2014; Lang & Lundholm, 1996; Lehavy, Li, & Merkley, 2011; Marston, 1997; Rajan & Servaes, 1997; Sabherwal & Smith, 2008).

In the UK context, Marston (1997) examines Bhushan's model for a sample of 251 firms listed on the main board in 1991. However, due to the unavailability of similar data on the main proxies (i.e., the number of analysts following, institutional holdings and insiders' holdings) to those employed in Bhushan (1989), Marston recommends repeating the study using all UK quoted companies to further examine the validity of Bhushan's model in the UK context. Hussain (2000) examines analyst coverage of the UK FTSE companies using a simultaneous equation framework to address the potential endogeneity problem between the number of analysts following and institutional ownership. However, the focus of these two studies is larger UK companies quoted on the main board so determinates of analysts following smaller and junior listed companies have not been previously investigated. In addition, both Hussain (2000) and Marston (1997) employ a classical linear regression model that does not suit datasets where the dependent variable (the number of analysts following a firm) is a discrete variable that takes only a finite number of nonnegative integers (Rock, Sedo, & Willenborg, 2001).

A review of prior studies shows more gaps in the current literature, which provides further motivation for this study. Firstly, the literature is mainly informed by US studies. This study covers the UK market, which is structurally different from the US market in an important aspect that is relevant to the demand for analyst services. Specifically, only 10.7% of listed equity in the UK is owned by individuals (Office of National Statistics, 2012), whereas the comparable figure for the US is 36.5% (US Census, 2012). This implies a higher concentration of institutional holdings in the UK as opposed to the US (ICAEW, 2007). This is important because the number of institutions and the percentage ownership held by institutions has been shown to be important determinants of the demand for analyst services in prior studies.

Secondly, although the sample constituents covered in prior studies sometimes belong to different listing locations (main market versus junior market); none has examined the possibility that the determinants of analyst coverage can be conditional on listing location. For instance, while Brennan and Hughes (1991), Chen et al. (2007) and Jiraporn et al. (2012) include main board NYSE/AMEX and junior market NASDAQ firms in their sample and Giraldo (2011) include stocks traded on six different trading venues including NYSE, NASDAQ and OTC, they do not examine whether the determinates of analyst services differ by listing location. Meanwhile, Baik et al. (2010), Jiraporn et al. (2014) and Rajan and Servaes (1997) include listed and non-listed firms in their sample and add a dummy for listing versus non-listed firms. This is a different issue than listing on the main board as opposed to the junior market partly because the hurdle from moving to the main board from the junior market is much lower than issuing an initial public offering. Moreover, we divert from prior studies by explicitly examining the impact of different listing requirements for listing on the main board as opposed to the junior market on analyst coverage. These include market capitalisation and free float.

Thirdly, unlike prior studies, we examine the effect of cross-listings on stock exchanges, over the counter markets and alternative trading

systems on analyst coverage. The salient difference among the three types of trading venues is transparency where stock exchanges allow dealers to see the full order book<sup>1</sup> whereas over the counter and especially alternative trading systems (dark pools) provide much less information on the demand and supply of shares. The potential impact of these different trading systems is especially important given the rise of alternative trading systems and the development of the London Stock Exchange to what is now popularly known as the world's premier international stock exchange.<sup>2</sup>

The current study examines the impact of listing location on analyst coverage using count data panel regressions that adjust for the count nature of the dependent variable as do Boubaker and Labégorre (2008) and Rock et al. (2001), but for more recent, non-US panel data. We employ count panel regression methods for a sample of 1194 UK listed companies from 2010 to 2015. The use of panel data provides a number of advantages over both the traditional cross-sectional and time-series analyses. It gives the researcher a larger number of observations, thus increasing the degrees of freedom for any statistical testing and lessening the problem of multicollinearity among the explanatory variables (Hsiao, 2002), thereby improving the efficiency of estimates.

We first include a dummy variable for the listing location to see if there is something special about being listed on the main board. We find that the location dummy is positive and highly significant. Moreover, it is clear that cross-listing on stock exchanges is positive but cross-listings on less transparent over the counter and alternative trading systems are inversely related to analyst coverage.

This means that stocks listed on the main board attract more analyst coverage than can be explained by existing factors. The question now is whether the listing requirements can explain this? To answer this question, we separately investigate how additionally controlling for differences in market capitalisation and free float changes the coefficient on the listing location dummy variable. We also conduct this examination for the main and junior markets individually to examine whether stocks from the main board and the junior market can be pooled together in the same dataset. In other words, we investigate whether the demand and supply functions for analyst services are the same for the main board and junior market stocks.

We find that market capitalisation positively impacts analyst coverage and that impact is significantly higher for the AIM companies. We also find that free float has a positive impact on the total and the AIM samples yet free float is inversely related to the number of analysts following for the FTSE350 sample. The difference in the impact of free float between the two markets is statistically significant. Together, the significant difference in the influence of market capitalisation and free float between the main board and the junior market hint that the demand and supply of analyst's services do vary by listing location so caution is advisable when suggesting which factors for analyst services are operative for pooled samples of main board and junior market stocks. Still, even when controlling for market capitalisation, free float and type of cross-listing, listing on the main board as opposed to the junior market has a significant positive influence on the number of analysts following a company.

The remainder of this paper is organised as follows. In Section 2, we develop our hypotheses. The model is presented in Section 3 while Section 4 describes the sample and discusses the results. Section 5 provides concluding remarks.

## 2. Hypothesis development

Individuals hold a larger portion of AIM companies than main board listed companies due to holdings by directors (Office of National Statistics, 2012). Accordingly, we expect that ownership dispersion is

<sup>1</sup> When dealers can see the full order book they can see the price and the quantity at all levels of the bid and ask. That is, the dealers can see the supply and demand curves for the shares.

<sup>2</sup> See <http://www.world-stock-exchanges.net/>.

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