

The roles of task-specific forecasting experience and innate ability in understanding analyst forecasting performance[☆]

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Abstract

Considerable debate exists about what analyst experience measures and whether analysts learn from their experiences. Extant research has argued that once innate ability is considered, analysts' general and firm-specific experiences are not relevant to understanding their forecasting performance. We argue that measures of experience need to be expanded to also include task-specific experience. Our results reveal that analysts' forecast accuracy is associated with both their innate ability and task-specific experience. In addition, we find that forecast accuracy and task-specific experience are most highly correlated for those analysts who survive the longest and, thus, presumably have the greatest innate abilities.

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1. Introduction

Prior empirical research in the analyst domain is inconclusive on the link between experience and forecasting performance. Clement (1999) reports that analysts' forecast accuracy improves with firm-specific experience (defined as the number of years of analyst forecasting experience with a specific firm). Mikhail et al. (1997, p. 132) report that analysts' forecast accuracy improves with firm-specific experience (defined as the number of prior quarters an analyst has issued a forecast for a particular firm). On the other hand, Jacob et al. (1999, p. 53) report, that after controlling for innate ability, no firm-specific experience effects can be discerned.¹ Jacob et al. conclude that only the highest-ability analysts survive at the job and, as a result, performance is not a function of analysts learning from their general or firm-specific forecasting experiences. This conclusion is somewhat perplexing as it is in contrast to substantial research in psychology and other applied fields, which suggests that both innate ability and experience are relevant to understanding human performance. The purpose of this study is to explore the roles of innate ability and a particular type of experience – namely, task-specific experience – in explaining analyst forecasting performance.

We believe it is important to study the roles of learning-from-experience and innate ability for at least two reasons. First, as suggested above, there is considerable debate in the literature about what analyst experience measures and whether analysts learn from their prior experiences at forecasting (Beaver, 2002). Given the large potential rewards accruing to the high-performing analysts and the firms that employ them (Stickel, 1992; Mikhail et al., 1999), it is important to understand what causes analysts to become accurate forecasters. Further, by better understanding the different skills and experiences that might be relevant to analyst performance, investors may be able to better predict when analysts will be able to perform at a high level and when they will not. Second, understanding what leads to high analyst performance could influence how their employers select and train those analysts. That is, if analyst performance is largely a function of innate ability, then firms that employ analysts would be most concerned with identifying those potential analysts with the highest innate ability and less concerned with their subsequent experiences. In contrast, if analyst performance is significantly determined by content learned from on-the-job experiences, then these firms would be concerned with providing the appropriate experiences and training to facilitate analyst learning and, thus, high performance.

In this paper, we draw on psychology-based research and hypothesize that *both* learning-from-experience and innate ability are likely to be relevant to explaining analysts' performance. In doing so, we argue that a previously unstudied aspect of analysts' experience – task-specific experience – may be the key to understanding why prior research found no evidence of learning from firm-specific experience once innate ability was considered. We define task-specific experience as the analyst's experience in forecasting around a particular kind of situation or event (what we refer to as the task), such as forecasting earnings when restructurings occur or forecasting earnings around an acquisition.² Prior research focuses on general and firm-specific experience, which we

¹In this study, we refer to the Jacob et al. (1999) aptitude variable (analyst-firm alignment) as innate ability.

²In other words, we define the task more narrowly than Mikhail, et al. (1997) who define the task as forecasting earnings for a particular firm, collapsing across all types of events or situations that occur for that firm. We refer

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