Accounting, Organizations and Society 39 (2014) 362–384

Contents lists available at ScienceDirect

Accounting, Organizations and Society

journal homepage: www.elsevier.com/locate/aos

The construction of calculative expertise: The integration of corporate governance into investment analyses by sell-side financial analysts ☆

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A B S T R A C T

This study analyses an emerging form of economic calculation in financial markets, namely, the integration of corporate governance into investment analyses undertaken by sell-side financial analysts. It examines how the expertise of these analysts in corporate governance integration is constructed, with particular attention to the calculative ideas and calculative devices through which it is achieved. Corporate governance integration is shaped by certain 'calculative ideas'. These relate to ideas about the potential link between corporate governance and financial performance and the ideal of incorporating governance criteria into the investment process. This paper suggests that these calculative ideas have constituted the discursive conditions under which analysts sought to build their expertise in a new domain. The paper also shows that at a time when the quality of traditional sell-side research was scrutinised, the investment professional association and constituents of the investing public, through their arguments and discourses, constructed analysts as the 'specialists' having the imperative and credibility to perform corporate governance integration. Furthermore, as the paper demonstrates, analysts have sought to 'theorize' calculative ideas. They have normatively deployed certain 'calculative devices' to make corporate governance integration operational. Corporate governance integration is conducted in ways that make it receptive to the claims of a particular form of expertise, that of analysts. This paper suggests that it is through the assemblage formed over time between the ideas and aspirations on the one hand, and the tools and devices on the other, that the expertise of analysts in corporate governance integration has gradually been formed.

Introduction

A number of high profile corporate governance failures occurred in the early 2000s, such as Enron, WorldCom, and Parmalat. This shook the global business landscape. Since then, corporate governance has been perceived as 'an area of risk' that may have material impacts on financial performance and shareholder value (Dallas & Patel, 2004; Solomon, 2010). Integrating corporate governance into the investment process has become an ideal to be sought within the investing public (The UN Global Compact, 2004, 2005, 2009; The UNEP FI, 2004). Whilst progress

☆ This paper is based on my doctoral thesis that I completed at the London School of Economics (LSE). The financial support from the Department of Accounting at the LSE is acknowledged. I am very grateful to Peter Miller for his academic support throughout this study. Earlier versions of the paper have been presented at the *Accounting, Organisations and Society* Seminar at the LSE, *The 2011 British Accounting and Finance Association Annual Conference*, *The 34th European Accounting Association Annual Congress*, and *The 2012 Interdisciplinary Perspectives on Accounting Conference*. I am grateful to the editor, David Cooper, and the two anonymous reviewers, who have helped to improve the paper considerably. I also wish to thank Richard Laughlin, Colin Clubb, Alex Preda, Jill Atkins, and Hanna Silvola for having read earlier versions of the manuscript and provided extremely useful comments.

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http://dx.doi.org/10.1016/j.aos.2014.05.003

has been made, a common understanding of how to incorporate governance criteria into the investment process is yet to be developed (The UN Global Compact, 2004: 1). Corporate governance integration is thus an immature field of practice which may leave room for expertise to develop (cf. Power, 1997a). This study analyses the integration of corporate governance into investment analyses conducted by sell-side financial analysts. Specifically, the paper focuses on examining how the expertise of these analysts in performing corporate governance integration is constructed, with particular attention to the calculative ideas and calculative devices through which it is achieved.

Sell-side financial analysts (analysts thereafter) work in the equity research divisions of brokerage firms. They are commonly perceived as experts in investment analysis and stock valuation. Research on governance and other extra-financial issues, however, has been driven mostly by specialist teams rather than individual analysts (EAI, 2008). In the early 2000s, major brokerage houses, such as Deutsche Bank, Citigroup, Goldman Sachs, JP Morgan, Merrill Lynch, and UBS, established dedicated teams to investigate corporate governance and other extra-financial issues. Analysts employed in these specialist teams are sometimes called corporate governance analysts, socially responsible investment (SRI) analysts, or environmental, social, and governance (ESG) analysts. These analysts may not offer investment recommendations directly to investors. Nevertheless, they have taken the initiative to explore ways in which issues such as corporate governance may be integrated into investment analyses, and have devoted considerable effort into seeking to demonstrate the importance of corporate governance in determining shareholder value.

This paper examines how the expertise of analysts in this particular form of economic calculation has been formed out of a set of calculative ideas and a related set of calculative devices. The ‘calculative ideas’ at stake here include ideas and discourses related to the potential link between corporate governance and financial performance, which have been articulated in academic research, public policy making, and institutional investment. They also include the ideal and aspiration of bringing corporate governance into the investment process that surfaced in the institutional investment community in the early 2000s. These ideas, discourses, and aspirations have constituted the discursive conditions of possibility for analysts to build their expertise in a new domain. Meanwhile, at a time when the quality of traditional sell-side research was scrutinised, i.e. in the early 2000s, the investment professional association and constituents of the investing public, through their arguments and discourses, constructed analysts as the ‘specialists’ having the imperative and credibility to perform corporate governance integration.

As specialists, analysts have sought to develop their own interpretation of the link between corporate governance and financial metrics. They have developed and deployed certain ‘calculative devices’, such as portfolio, event, and regression analyses, and the associated graphs, to make this link newly visible, measurable, and calculable. More importantly, analysts have attempted to combine the assessment of the governance of a company with its broader investment thesis. They have normatively developed certain principles and mechanisms (e.g. the ‘governance–valuation–profitability’ analyses and graphs) to fulfill the objective of incorporating governance criteria into investment analyses. It is through the assemblage formed over time between the ideas and aspirations on the one hand, and the tools and devices on the other, that the expertise of analysts in corporate governance integration has gradually been formed. Fig. 1 summarises these key insights.

This study seeks to contribute to the literature along three dimensions. First, this paper fills a gap in the literature that has failed to address how analysts develop expertise concerning a new domain in their investment advice. Prior research has considered mainly the expertise of traditional sell-side investment research (Beunza & Garud, 2007; Fogarty & Rogers, 2005). The issue of how analysts build expertise to operate in a new domain has not been systematically examined. This paper addresses this limitation by investigating how the expertise of analysts in corporate governance integration is formed, particularly at a time when the quality of their traditional work has been questioned. This paper also shows that analysts do not appear to aim to achieve enclosure over their expertise in this new field of practice. These important empirical insights add to those already contained in the literature on professional expertise in economic sociology and the sociology of accounting (Gendron, Cooper, & Townley, 2007; Power, 1992, 1997a; Preda, 2002, 2007).

Second, this paper adds to the ‘governmentality’ literature by making the role of experts and expertise more explicit. Accounting scholars whose research is informed by the ‘governmentality’ literature argue that economic calculation is constituted along two dimensions, the ‘programmatic’ and the ‘technological’ (Mennicken, Miller, & Samiolo, 2008; Miller, 2008b; Power, 1997b). This study builds on these arguments by examining the ideas articulating and the devices operationalising corporate governance integration. The paper has taken one step further and attended specifically to one of the consequences of the assemblage formed over time between calculative ideas and calculative devices, that is, the constitution of calculative expertise. This particular approach to analysing corporate governance integration and the expertise developed sheds new light on our conceptualisation of the constructive nature of calculative expertise.

Third, aligned with the ‘governmentality’ literature, this paper attends to the role of expertise as ‘relays’, i.e. interpreting calculative ideas and creating calculative devices, in the forming of particular modes of economic calculation (Miller & Rose, 1990). This literature, however, fails to address properly how expertise stabilises linkages between programmes and specific technologies (Gendron et al., 2007: 103). To address this limitation, this paper articulates more fully the ‘relay’ aspect at issue here by viewing experts as ‘theorizing agents’, a notion that is drawn from neo-institutional analyses (Sahlin-Andersson & Engwall, 2002; Strang & Meyer, 1993). Analysts, the ‘theorizing agents’ under investigation, are viewed to link up the ideas and the devices of a particular form of economic calculation. The ‘theorization’ by analysts, as the paper also demonstrates, is part and parcel of the process of constructing their calculative expertise.