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# The revision frequency of earnings forecasts and firm characteristics



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### ABSTRACT

This study investigates how the revision frequency of earnings forecasts affects firm characteristics. Previous studies generally focus on the number of analysts following a firm to measure a firm's information environment. The frequency with which news is updated is often defined as an analyst's effort. Analysts provide more information to investors if they update news more frequently. This study examines whether the frequency of information updating for a particular firm affects the firm's performance. We apply three proxies for firm performance: stock liquidity, the cost of equity capital, and firm value. Our findings indicate that the analysts' effort as measured by the frequency of news updating is effective in providing additional power beyond the number of analysts to represent the information environment of a firm. Therefore, this study suggests that combining both the number of analysts following a firm and the frequency of news updating can be a better proxy for assessing a firm's information environment.

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## 1. Introduction

This study investigates how the frequency of news updating by analyst affects firm characteristics. Previous studies generally take the number of analysts following a firm as a proxy to measure the information environment of a firm (Francis & Soffer, 1997; Lang & Lundholm, 1996). As information intermediaries (Healy & Palepu, 2001), analysts provide research reports to market participants, enabling them to access more detailed information on particular firms (Francis & Soffer, 1997). Indeed, the information environment of a firm is improved if it is followed by more analysts. However, we can also postulate that more information of a firm could be transmitted to the capital market if analysts update information about the firm more frequently. Thus, this study investigates whether the frequency of news updating helps to enhance the information environment of a firm, in turn improving important firm characteristics such as degree of liquidity, cost of equity, and firm value.

In this study, we measure the frequency of news updating by the number of times that an analyst revises earnings forecasts for the firm. The frequency of news updating by analysts can be regarded as an analyst's effort, as suggested by McNichols and O'Brien (1997) and Jacob, Lys, and Neale (1999). But an analyst may not put the same effort into each individual firm in his covered portfolio. Lin, Yang, and Lo (2012) document that analysts are less likely to revise earnings forecast for weakly correlated firms in their covered portfolio. In this study, we propose that it is possible a company is followed by few analysts, but each analyst expends tremendous effort in updating news about their covered firms more frequently. In this case, information on the firm is still transmitted rapidly to capital markets, but the proxy of total number of analysts following does not reflect this fact. Consistent with our argument, Holden and Stuerke (2008) find that the revision frequency of earnings forecasts is positively associated with a firm's trading volume in stock market. This suggests that it is important to account for whether an analyst updates a firm's news frequently.

In addition to examining the effect of the frequency of news updating on firm performance, this study also proposes an indicator, *Total Frequency*, as a proxy of information environment of a firm, which includes both the number of analysts following a firm and the frequency of news updating. Total frequency equals the sum of the earnings revision over each analyst for a particular firm. Therefore, the coefficient of this indicator would be higher if more analysts analyze the firm and certain analysts often update news for the firm.

We examine the relation between frequency of revision and three important firm characteristics: stock liquidity, the cost of equity capital, and firm value. We hypothesize that a firm with a better information environment transmits news to capital markets more rapidly and investors access information more easily. Thus, the liquidity of the stock is improved since information asymmetry between the firm and investors declines. In addition, reducing information asymmetry also helps to lower the cost of capital, raising firm value.

The majority of our arguments are supported by our empirical results. Total frequency, the cumulative effect of the number of analysts and revision frequency, has a positive effect on firm performance. Even when we decompose Total frequency into the number of analysts and the frequency of news updating, the frequency of news updating still improves firm performance in most tests. These results suggest that it is better to account for the number of analysts following and the frequency of news updating when measuring the information environment of a firm.

This study makes several distinct contributions to the literature. First, Holden and Stuerke (2008) suggest revision frequency is associated with a firm's trading volume, the variability of the firm's earnings process, and the earnings response coefficient. We confirm their findings that revision frequency of earnings forecast is positively associated with stock liquidity. Second, we also examine the association of revision frequency with the cost of equity and firm value, providing a more in depth analysis of this research topic. Third, previous research (Ramnath, Rock, & Shane, 2008) generally indicates that the research reports of financial analysts, such as earnings forecasts or stock recommendations, will affect stock price, trading volume, or investors' impressions of the firm. Our paper highlights analyst effort rather than exploring the content of analyst research reports. We study how analyst revision frequency improves the firm's information environment and leads to better firm performance. Our findings suggest the analysts' effort provides additional power, beyond the number of analysts, to

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