Corporate Reputation And Analyst Coverage: Evidence From Europe

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ABSTRACT

Does corporate reputation affect analyst's decision to cover a firm? This paper uses the data from Europe (Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Norway, Poland, Russia, Spain, Sweden, and Turkey) to show that analyst coverage is an increasing function of corporate reputation during the period between 2008 and 2013. Our results are consistent with Gabbioneta et al. (2007) who show that corporate reputation increases the emotional appeal of a firm in the eyes of analysts. Furthermore, we also argue that investors are interested in firms with better reputation. It is, therefore, possible that investors demand analyst research for more these firms, thereby resulting in higher analyst coverage for these firms. Our results are robust in different sub-samples and in different estimation procedures.

Keywords: Corporate Reputation; Analyst Coverage

1. INTRODUCTION

Corporate reputation is defined as a set of collectively held beliefs about a firm's ability to satisfy the interests of its various stakeholders. It is an additional construct that combines cognitive dimensions and is based on firm's characteristics, such as firm's products and services, its strategy and quality of management, and its market position. Lee and Roh (2012) argue that corporate reputation differentiates a firm from others and attracts customers, suppliers, employees, and investors. Most of prior literature presents evidence on how corporate reputation helps firms to accrue benefits from different groups of stakeholders (Boyd et al., 2010; Bergh et al., 2010; Roberts and Dowling, 2002). Cornell and Shapiro (1987), for instance, show that quality of firm's reputation increases its ability to engage in cheaper implicit contracts. They note that various claims issued by firms take the form of tacit promises of continuing supply, timely delivery, product enhancement, and job security. These claims are relatively cheaper to implement than explicit contracts and firms with high reputation are better positioned to take benefit of these claims. In another related study, Boyd et al. (2010) show that employees desire to work for firms with good reputations. As a result, reputable firms are able to recruit and retain a competent work force with less contracting and monitoring costs. This strand of literature argues that reputation serves as a signal to outside stakeholders that firm's offers (such as its products and services, employment conditions, or investment opportunities) are of high quality. A reputable firm, therefore, enjoys favorable premiums in various economic transactions relative to other firms. Favorable premiums enjoyed by reputable firms, eventually, translate into superior financial performance of these firms. Antunovich and Laster (1998) document that portfolio of the most reputable firms generate a one-year abnormal return of 3.20% and a three-year abnormal return of 8.30%. They also show that portfolio of the least reputable firms earn a negative abnormal return of 8.60%. In another related study, Clayman (1987) finds that the reputable firms outperform S&P500 by 1.10% a year. Beatty and Ritter (1986) argue that greater interest from investors translates into lower capital costs, thereby positively affecting the performance of firms with high reputation.

An important group of stakeholders that has received relatively lesser attention in prior literature on corporate reputation is financial analysts. Financial analysts are agents that gather, interpret and disseminate information about firms to investors. This paper argues that financial analysts are attracted towards firms with high reputation for a number of reasons.

- First, analyst's decision to cover a certain firm is a function of the demand generated by investors for analyst's research. We argue that firms having good reputation among investors are more likely to generate greater demand for analyst's research. Investors, being interested in these firms, would like to demand more information about these firms. Analysts are likely to respond to this increased demand of information by increasing their coverage.
- Second, corporate reputation may increase emotional appeal of a firm in the eyes of analysts. Gabbioneta et al. (2007) document that corporate reputation displays a high correlation with the overall disposition of financial analysts towards a firm. They show that firms with better reputation are preferred by analysts. Greater emotional appeal associated with reputable firms, therefore, leads to increase in analyst coverage.
- Third, we believe that analysts have incentive to cover those firms that are more likely to generate trading from investors. Analyst's compensation is, partly, a function of the trading that he generates via his research. We argue that it is easier for analysts to generate trading for firms that already enjoy good reputation among investors. Therefore, it is likely that analysts will cover firms that have good reputation.

Consistent with above arguments, this paper shows that the extent of analyst coverage is an increasing function of corporate reputation in Europe (Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Norway, Poland, Russia, Spain, Sweden, and Turkey) during the period between 2008 and 2013. We show significantly positive relationship between the extent of analyst coverage and corporate reputation during our sample period. Our arguments are consistent with Gabbioneta et al. (2007) who show that corporate reputation displays a high correlation with the overall disposition of financial analysts towards a firm. Reputation enhances the emotional appeal of a firm in the eyes of analysts and induces them to cover these firms. Our results have implications for firms in a way that it highlights the channel via which firms can attract more analysts. Given that analyst coverage can enhance firm value (Farooq and Satt, 2014), any channel that can help improve analyst coverage is important.

The remainder of the paper is structured as follows: Section 2 summarizes the data. Section 3 presents assessment of our arguments and Section 4 document robustness of our analysis. The paper ends with Section 5 where we present conclusions.

2. DATA

This paper documents the impact of corporate reputation on the extent of analyst coverage in Europe during the period between 2008 and 2013. For the purpose of this paper, our sample comprise of firms listed in Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Norway, Poland, Russia, Spain, Sweden, and Turkey. All data is in Euros. Following sub-sections explain the data in more details.

2.1 Corporate Reputation

Reputation is defined as a consensus impression about how a firm will behave in any given situation (Bromley, 2002; Sandberg, 2002). It is based on a set of collectively held beliefs about a firm's ability and willingness to satisfy the interests of various stakeholders (Fombrun, 1996). This paper uses the data from Datastream to develop an index of corporate reputation (CR). Datastream provides the binary data for the following items related to various dimensions of corporate reputation: The first item (CR1) indicates whether the company has a policy to avoid bribery and corruption. The second item (CR2) indicates whether the company has a policy towards business ethics. The third item (CR3) shows whether the company has a policy to be a fair competitor. The fourth item (CR4) shows whether the company has a policy to increase the indirect economic impact on local communities. The fifth item (CR5) indicates whether the company has a policy to treat its suppliers and contractors as key business partners. The last item (CR6) indicates whether the company monitors its reputation with communities? The above items capture various aspects of a firm's structure, policies and practices that constitute good corporate reputation. Each item is constructed in a way such that presence of that item adds one point to the reputation score. Thus, the rating is on a scale of zero to six, with a higher score indicating better corporate reputation. A total corporate reputation score for each firm is calculated each year. Table 1 documents descriptive statistics for corporate reputation index (CR). Our

results in Table 1 show that Italy and Spain have significantly higher corporate reputation score than other countries. We also show that Poland has the least corporate reputation score. Table 1 also shows that firms headquartered in Western Europe have relatively higher emphasis on corporate reputation than firms headquartered in other countries.

Table 1. Descriptive statistics for corporate reputation

	Countries	Mean	Median	Standard Deviation	No. of Observations
Emerging Europe	Czech Republic	2.3970	2.0000	0.7753	68
	Greece	1.4960	1.0000	1.8434	252
	Poland	1.1004	0.0000	1.5677	219
	Russia	2.0113	2.0000	1.8236	176
	Turkey	1.9508	2.0000	1.4498	183
North Europe	Denmark	1.8026	2.0000	1.7129	375
	Finland	2.8699	3.0000	1.4610	469
	Norway	2.7546	3.0000	1.3640	481
	Sweden	2.8972	3.0000	1.3776	886
West Europe	France	2.8616	3.0000	1.8464	1424
	Germany	2.7574	3.0000	1.8180	1080
	Italy	3.5220	4.0000	1.8318	795
	Spain	3.4537	4.0000	1.7446	725

2.2 Analyst Coverage

We define analyst coverage (ANALYST) by the maximum number of analysts issuing annual earnings forecasts in a given year. Greater the number of analysts covering a firm, the better is its information environment. Data for analyst coverage is obtained from I/B/E/S. Table 2 documents the descriptive statistics for analyst coverage during our sample period. We include only those firms in our analysis for which we have the data for corporate reputation. Our results show that firms headquartered in Western Europe have higher analyst coverage, followed by firms headquartered in Northern Europe and Emerging Europe.

Table 2. Descriptive statistics for analyst coverage

	Countries	Mean	Median	Standard Deviation	No. of Observations
Emerging Europe	Czech Republic	15.8939	17.0000	6.5542	66
	Greece	13.5990	13.0000	6.6521	217
	Poland	13.5518	12.0000	5.4548	212
	Russia	6.1603	4.0000	5.1402	106
	Turkey	19.2705	19.0000	4.9336	170
North Europe	Denmark	15.5614	14.0000	8.7105	301
	Finland	19.9855	18.0000	11.1528	346
	Norway	20.5879	19.0000	7.6668	432
	Sweden	18.0049	17.0000	8.5631	806
West Europe	France	21.1170	21.0000	8.7122	1333
	Germany	25.7272	27.0000	9.5565	957
	Italy	17.6349	16.0000	10.5656	693
	Spain	23.8636	24.0000	9.1371	660

2.3 Control Variables

We use log of total assets (SIZE), total debt to total asset ratio (LEVERAGE), dividend payout ratio (PoR), and growth in total assets (GROWTH) as control variables. The data for control variables is taken from the Worldscope. We argue that these variables define the information environment of a firm to varying degrees. For instance, larger firms are more complex and therefore have higher information asymmetries (Vermaelen, 1981; Diamond and Verrecchia, 1991). Firms with high leverage and growth are more risky and therefore require more careful evaluation (Smith and Watts, 1992; McLaughlin et al., 1998). Firms with higher payout ratios or earnings are more likely to have better information environments (Jegadeesh, et al., 2004; LaPorta et al., 2000). Prior literature considers information environment as a significant determinant of analyst coverage. However, the sign of this

relationship – positive versus negative – is inconclusive. On one extreme is a literature that considers negative impact of information environment on analyst coverage. For example, Lang et al. (2004) find that analysts are less likely to follow firms with high information asymmetries. While on the other extreme is the literature that documents the opposite. Lang and Lundholm (1996), for example, find that analyst coverage is positively correlated with disclosure quality.

Table 3 documents descriptive statistics for control variable. An interesting observation in Panel A is relatively low payout ratios by European firms during our sample period. Given that our sample period is the post-crisis period, we expect firms to be relatively conservative in their payout ratios. Furthermore, Panel B shows no severe multicollinearity problems between control variables. As a result, we can include all of these variables in regression equations.

Table 3. Summary statistics for analyst coverage

Panel A: Descriptive statistics					
Variables	Mean	Median	Standard Deviation	No. of Observations	
SIZE	17.0068	17.0097	1.9670	6999	
LEVERAGE	27.4496	26.5600	16.5593	6937	
PoR	36.5348	36.4200	27.3605	6002	
EPS	6.0173	1.4800	24.3549	6247	
GROWTH	9.8249	0.0000	72.9220	5263	

Panel B: Correlation matrix					
Variables	SIZE	LEVERAGE	PoR	EPS	GROWTH
SIZE	1.0000				
LEVERAGE	0.0827	1.0000			
PoR	-0.0519	-0.0203	1.0000		
EPS	0.2162	-0.0943	-0.0568	1.0000	
GROWTH	-0.0213	-0.0490	-0.0590	-0.0162	1.0000

3. METHODOLOGY

In order to document the impact of corporate reputation on analyst coverage, we estimate the following regressions with the extent of analyst coverage (ANALYST) as a dependent variable and corporate reputation index (CR) as independent variable. All variables are defined as above. We use panel regression with fixed effects to estimate the following regressions. Hausman test is used to decide between the presence of fixed effects or random effects.

$$\text{ANALYST} = \alpha + \beta_1(\text{CR}) + \varepsilon \quad (1)$$

$$\text{ANALYST} = \alpha + \beta_1(\text{CR}) + \beta_2(\text{SIZE}) + \varepsilon \quad (2)$$

$$\text{ANALYST} = \alpha + \beta_1(\text{CR}) + \beta_2(\text{SIZE}) + \beta_3(\text{LEV}) + \beta_4(\text{PoR}) + \beta_5(\text{EPS}) + \beta_6(\text{GROWTH}) + \varepsilon \quad (3)$$

Table 4 documents the results of our analysis. Our results show that higher corporate reputation score leads to higher analyst coverage. We document significantly positive coefficient of CR for all equations. Consistent with above arguments, we argue that firms having good reputation among investors are more likely to generate greater demand for analyst's research. Investors, being interested in these firms, would like to demand more information about these firms. Analysts are likely to respond to this increased demand of information by increasing their coverage.

Table 4. Effect of corporate reputation on analyst coverage

Variables	Equation (1)	Equation (2)	Equation (3)
CR	0.3101***	0.2680***	0.2862***
SIZE		3.0379***	2.4983***
LEVERAGE			-0.0600***
PoR			0.0155***
EPS			-0.0098*
GROWTH			-0.0018***
Fixed Effects	Yes	Yes	Yes
No. of Observations	7133	6999	4189
No. of Groups	1304	1280	1092
F-Value	117.09***	117.36***	63.12***

NOTE: Coefficients with 1% significance are followed by ***, coefficient with 5% significance by **, and coefficients with 10% significance by *.

4. ROBUSTNESS CHECKS

4.1 Effect of Corporate Reputation on Analyst Coverage in Different Sub-Samples Based on Size

As a first robustness check, we divide our sample into sub-groups of small, medium, and large firms. We re-estimate Equation (3) for all sub-groups. Our results are reported in Table 5. Our results show that higher corporate reputation leads to greater analyst coverage in sub-groups of small and medium firms. We report significantly positive coefficient for CR for these sub-groups. Interestingly, our results also show that there is no impact of corporate reputation on analyst coverage for large firms. We report insignificant coefficient for CR for large firms. We argue that larger firms have more resources to manage their reputation. Therefore, it is possible that all large firms have put in place better policies to manage their reputation. As a result, there may not be enough variation in CR within large firms, thereby resulting in insignificant relationship between corporate reputation and analyst coverage.

Table 5. Effect of corporate reputation on analyst coverage in different sub-samples based on size

Variables	Small Firms	Medium Firms	Large Firms
CR	0.3820***	0.3534***	-0.0086
SIZE	3.0946***	1.5199***	3.9321***
LEVERAGE	-0.0618***	-0.0597***	-0.0709**
PoR	0.0186***	-0.0063	0.0389***
EPS	-0.0322	-0.0193	-0.0084
GROWTH	-0.0032**	-0.0006	-0.0027**
Fixed Effects	Yes	Yes	Yes
No. of Observations	1393	1359	1437
No. of Groups	398	407	380
F-Value	16.61***	32.00***	38.94***

NOTE: Coefficients with 1% significance are followed by ***, coefficient with 5% significance by **, and coefficients with 10% significance by *.

4.2 Effect of Corporate Reputation on Analyst Coverage in Different Sub-Samples Based on Regions

As a second robustness check, we divide our sample into three sub-groups. First sub-group comprises of firms headquartered in France, Germany, Italy, and Spain (West Europe), second sub-group consists of firms headquartered in Finland, Sweden, Norway, and Denmark (North Europe), and third sub-group consists of firms in Russia, Turkey, Greece, Poland, and Czech Republic (Emerging Europe). We re-estimate Equation (3) for all sub-groups. Our results are reported in Table 6. We show that corporate reputation is a significant determinant of analyst coverage in West Europe and in North Europe. We report significantly positive coefficient of CR for these sub-groups. In case of Emerging Europe, we report no impact of corporate reputation on analyst coverage. We report insignificant coefficient of CR for Emerging Europe. This result is interesting because it indicates that analysts do

not cover firms with high reputation in these markets – probably because demand for analyst coverage may be high for firms with lower reputation.

Table 6. Effect of corporate reputation on analyst coverage in different sub-samples based on regions

Variables	West Europe	North Europe	Emerging Europe
CR	0.3681***	0.2710**	-0.0445
SIZE	3.3282***	0.9140*	1.6438*
LEVERAGE	-0.0823***	-0.0921***	0.0239
PoR	0.0057	0.0129	0.0470***
EPS	-0.1840***	0.0193*	-0.0083*
GROWTH	-0.0034***	0.0005	-0.0034*
Fixed Effects	Yes	Yes	Yes
No. of Observations	2480	1202	507
No. of Groups	632	306	154
F-Value	42.33***	19.69***	13.55***

NOTE: Coefficients with 1% significance are followed by ***, coefficient with 5% significance by **, and coefficients with 10% significance by *.

4.3 Effect of Corporate Reputation on Analyst Coverage at Different Quantiles

Our analysis implies that no matter what point on the conditional distribution is analyzed, the estimate of the relationship between corporate reputation and analyst coverage is the same. To test the empirical validity of this restrictive assumption and to document the relationship at different points of conditional distribution of analyst coverage, a quantile regression is applied at five quantiles (namely 0.10, 0.30, 0.50, 0.70, and 0.90). The results of our analysis are reported in Table 7. As was shown above, our results indicate that positive impact of corporate reputation on analyst coverage at all quantiles. We report significantly positive coefficient of CR for all quantiles.

Table 7. Effect of corporate reputation on analyst coverage at different quantiles

Variables	0.10	0.30	0.50	0.70	0.90
CR	0.8334***	1.5591***	1.4068***	1.5272***	1.3107***
SIZE	-0.9170***	1.3577***	1.9600***	2.2098***	2.0527***
LEVERAGE	0.0023	-0.0255**	-0.0254*	-0.0429***	-0.0639***
PoR	0.0235***	0.0533***	0.0616***	0.0532***	0.0511***
EPS	-0.0076	-0.0861***	-0.0763***	-0.0490**	-0.0471***
GROWTH	-0.0004	0.0005	-0.0003	-0.0041*	-0.0062***
Year Dummies	Yes	Yes	Yes	Yes	Yes
Country Dummies	Yes	Yes	Yes	Yes	Yes
Industry Dummies	Yes	Yes	Yes	Yes	Yes
No. of Observations	4189	4189	4189	4189	4189
Pseudo R-Square	0.0610	0.0852	0.1536	0.2097	0.2586

NOTE: Coefficients with 1% significance are followed by ***, coefficient with 5% significance by **, and coefficients with 10% significance by *.

4.4 Effect of Different Dimensions of Corporate Reputation on Analyst Coverage

There may be concerns that not all aspects of corporate reputation are important for analyst coverage. In order to address this concern, we re-estimate Equation (3) by replacing CR with the individual components of corporate reputation index. The results of our analysis are reported in Table 8. Our results show that CR2 (whether the company has a policy towards business ethics), CR3 (whether the company has a policy to be a fair competitor) and CR4 (whether the company has a policy to increase the indirect economic impact on local communities) do not affect the extent of analyst coverage. We report insignificant coefficients for these variables. The remaining three components of corporate reputation index (CR1, CR5, and CR6) are significantly related with analyst coverage.

Table 8. Effect of different dimensions of corporate reputation on analyst coverage

Variables	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)	Model (6)
CR1	0.5572*					
CR2		0.1400				
CR3			0.4763			
CR4				0.3096		
CR5					0.5266*	
CR6						0.7830***
SIZE	2.4370***	2.4973***	2.5222***	2.5325***	2.4957***	2.5878***
LEVERAGE	-0.0597***	-0.0607***	-0.0616***	-0.0610***	-0.0609***	-0.0637***
PoR	0.0158***	0.0158***	0.0155***	0.0157***	0.0156***	0.0156***
EPS	-0.0097*	-0.0095*	-0.0097*	-0.0092*	-0.0095*	-0.0096*
GROWTH	-0.0018***	-0.0018***	-0.0019***	-0.0018***	-0.0018***	-0.0018***
Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
No. of Observations	4189	4189	4189	4189	4189	4189
No. of Groups	1092	1092	1092	1092	1092	1092
F-Value	62.86***	62.07***	62.55***	61.93***	61.60***	63.17

NOTE: Coefficients with 1% significance are followed by ***, coefficient with 5% significance by **, and coefficients with 10% significance by *.

5. CONCLUSION

This paper uses the data from Europe to document the relationship between corporate reputation and analyst coverage during the period between 2008 and 2013. Our results show that firms with higher reputation are followed by more analysts. Our results are consistent with Gabbioneta et al. (2007) who document that corporate reputation displays a high correlation with the overall disposition of financial analysts towards a firm. We argue that preference of analysts for firms with high corporate reputation may also be driven by the fact that these firms enjoy good reputation among investors. As a result, it is possible that investors demand analyst services for these firms more than other firms. We also show that our results are robust for different estimation procedures.

AUTHOR BIOGRAPHY

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