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Abstract

Equity research analysts tend to cover firms about which they have favorable views. We exploit this tendency to infer analysts' preferences for corporate policies from their coverage decisions. We then use exogenous analyst disappearances to examine the effect of these preferences on corporate policies. After an analyst disappears, firms change their policies in the direction opposite to the analyst's preferences. The influence of analyst preferences on policies is stronger for firms for which analyst coverage is likely to matter more: young firms, and firms with higher market valuations. Our results suggest that firms choose their corporate policies, in part, to be consistent with the preferences of their analysts.

Keywords: Equity Research Analysts, Preferences, Real Effects, Investment, Financing, Payouts, Leverage, Cash Holdings

JEL Classifications: G24, G31, G32, G34, G35

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ABSTRACT

Equity research analysts tend to cover firms about which they have favorable views. We exploit this tendency to infer analysts' preferences for corporate policies from their coverage decisions. We then use exogenous analyst disappearances to examine the effect of these preferences on corporate policies. After an analyst disappears, firms change their policies in the direction opposite to the analyst's preferences. The influence of analyst preferences on policies is stronger for firms for which analyst coverage is likely to matter more: young firms, and firms with higher market valuations. Our results suggest that firms choose their corporate policies, in part, to be consistent with the preferences of their analysts.

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> *"And we, the analysts, were at the nexus of it all. On one hand, we were trying to deliver thoughtful analysis on what the deals really meant; on the other, we were influencing the deals themselves by advising the companies involved and pushing our vision of the industry out to the world with our research."*[1]

Investors are the ostensible audience of equity research analysts. The most visible outputs produced by these analysts – investment recommendations and earnings forecasts – are key inputs in investors' stock-picking decisions (Womack (1996), Juergens and Lindsey (2009)), while the analysts' performance is typically evaluated based on whether investors benefit from their recommendations and estimates (Hong and Kubik (2003)). Yet research produced by equity research analysts may have an influence beyond its main audience and may impact decisions made by the management of the firms they follow. In some situations, analysts may deliberately express disapproval of firms' key financial decisions – in the media or in direct meetings with management – to induce changes consistent with their personal views. For example, consider this recent statement made by an analyst following Apple on the controversy surrounding Apple's large cash holdings: "In our view, Apple's need for cash on hand is larger than many believe, and we see an acceleration of traditional dividends/buybacks as providing greater strategic flexibility for Apple and value to shareholders than preferred shares over the intermediate to long term."[2] The financial press contains a great many similar examples: Equity research analysts have strong views about the policies of the firms they cover. This paper asks whether these views affect the corporate policies of those firms. In a nutshell, we find that they do: Firms cater to the idiosyncratic preferences of sell-side analysts when deciding on their corporate investment policy (capital expenditures, R&D, acquisitions), financing policy (debt and equity issues), and cash and payout policy (dividends, share repurchases).

[1] Reingold (2006) p.133.
[2] http://www.foxbusiness.com/markets/2013/02/27/apple-may-need-to-keep-more-cash-analyst/#ixzz2N1Z1LFaU.

There are several reasons to think that analysts may influence corporate policies. First, analysts may be better informed than company management about important industry trends. They are specifically trained to analyze financial information, and they have access to many sources of information, including the management of the competitors of the firms they follow. They may also convey to managers the opinions of investors, the largest of which are in regular contact with sell-side analysts. Consistent with the role of analysts as gatherers and processors of information, a large literature suggests that analysts' recommendations move stock prices (e.g., Womack (1996), Barber et al. (2001) and Jegadeesh et al. (2004)), and that consequently these recommendations carry weight with company management. Second, analysts do not simply produce information for investors about the firms that they cover; they also monitor these firms, at least indirectly. Chen, Harford, and Lin (2012) find that analysts reduce the propensity to undertake value-destroying acquisitions, curb excess CEO compensation, and decrease earnings management. Yu (2008) finds that increases in analyst coverage are associated with decreases in earnings management, and Irani and Oesch (2012) find that exogenous drops of analyst coverage lead to a deterioration of financial reporting quality. Practitioners, if not academics, have long recognized that analyst research is not just investor-oriented – it also aims at influencing company policies. In the words of Graham and Dodd (1940):

> *"[The analyst] must concern himself with all corporate policies affecting the security owner, for the value of the issue which he analyzes may be largely dependent upon the acts of the management. In this category are included questions of capitalization set-up, of dividend and expansion policies, of managerial compensation, and even of continuing or liquidating an unprofitable business. On these matters of varied import, security analysis may be competent to express critical judgments, looking to the avoidance of mistakes, to the correction of abuses, and to the better protection of those owning bonds or stocks."*

A careful investigation of equity research analysts' preferences and of their influence on corporate policies needs to overcome a number of empirical challenges. First, while analysts' views are often presented anecdotally and qualitatively, we need to measure them systematically and quantitatively. To identify analyst preferences with respect to corporate policies, we make some simplifying choices. Most significantly, we focus on the components of the analysts' policy preferences that are constant across firms and across time. We measure analyst preferences for a broad set of corporate policies. Some of the policies we consider are decided by firm management (e.g., investment, acquisitions, payout); others are the outcome of a broad array of company decisions and competitive interactions in the product marketplace (e.g., growth or leverage).

Analyst preferences may reflect skills, beliefs, or incentives. For example, certain analysts may better understand the value implications of acquisitions than other analysts. Therefore, they may prefer firms to undertake acquisitions because their expertise gives them an edge over other analysts, either in terms of the relevance of their investment recommendations or in the accuracy of their earnings estimates. Second, analyst preferences may be determined by beliefs, i.e., by personal taste unrelated to expertise or information (e.g., see Malmendier, Tate, and Yan (2011) for evidence on managers). For example, analysts who are conservative by nature may prefer firms that build assets rather than firms that acquire them. Finally, analysts' preferences may be due to their economic incentives: Analysts that work for investment banks providing M&A advisory services may prefer firms that do a larger number of acquisitions relative to other firms.

To identify individual analyst preferences, we exploit the fact that analysts tend to choose to cover firms about which they have positive views, and choose not to cover firms about which they have negative views (McNichols and O'Brien (1997)). We assume that analysts' coverage

decisions are based, at least in part, on their preferences for corporate policies.[3] We estimate an analyst's preferences as the typical corporate policies pursued by the firms that he or she covers during his or her career. For example, we infer that analysts who tend to cover firms that make significant capital expenditures have a preference for CAPEX. In practice, for each of the policies that we consider, we use a panel of analyst-year-firm observations and regress the year- and industry-adjusted corporate policy on control variables for the standard determinants of the policy and firm, year, and analyst fixed effects. The analyst fixed effects represent the coverage decisions of analysts in any given year, and the estimated coefficients are our estimates of preferences for the policy. The preferences for corporate policies that we estimate for each analyst in this manner are significantly different from those we obtain by simulating random coverage decisions by analysts. They also appear to be economically consistent. For example, using factor analysis we find that some analysts prefer high share issuance and low debt, or internal growth with debt financing, whereas other analysts have a preference for generous payout policies (high dividend and/or share repurchases).[4]

The second empirical challenge we face in this study is to find a valid counterfactual to identify the *influence* of analyst preferences on corporate policies. Causal inference is made difficult by the fundamental endogeneity between analyst coverage decisions, analyst preferences, and corporate policies. For example, analysts might stop covering firms that are expected to change their corporate policies away from the analysts' preferences. To address this

[3] Analysts may not have full discretion over which firms they cover for their brokerage houses. To mitigate this problem, we restrict the estimation of analyst preferences to non-S&P 500 firms. Arguably, analysts have more discretion in deciding to cover - or not cover - a small industrial company than, e.g., General Electric. Our results are not sensitive to this methodology choice.

[4] The method that we use to estimate analyst fixed effects is similar to that of Bertrand and Schoar (2003) and Cronqvist and Fahlenbrach (2009), who study the effect of managers and blockholders, respectively, on corporate policies. However, our approach to estimate the effect of analyst preferences on corporate policies is different from these authors' and is much closer to the approach of Fee, Hadlock and Pierce (2013). We use exogenous shocks as quasi-natural experiments to identify the causal effects of analyst coverage on firms' policies.

issue, we examine the changes in corporate policies after exogenous analyst disappearances leading to the end of analysts' careers. We use two sources of exogenous analyst disappearances. First, we use a large set of analysts who disappear from the I/B/E/S database for reasons such as promotion, retirement, career change, or death. Analysts who disappear from I/B/E/S terminate coverage of all firms on their coverage list. We repeat the analysis on a subsample of analyst disappearances due to brokerage house mergers, as in Hong and Kacperczyk (2010), or to brokerage house closures, as in Kelly and Ljungqvist (2012). We posit that an analyst is less likely to influence a firm when he or she does not cover it than when he or she does. Consistent with this assumption and with our analyst influence hypothesis, we find that after an analyst disappears, firms shift their corporate policies away from the analyst's preferences and toward the new mean preference of the other analysts still covering the firm. For instance, firms tend to ramp up their capital expenditures when an analyst with a negative CAPEX preference stops covering them, if the analysts still covering the firms have a positive average CAPEX preference. The effects of analyst preferences are monotonic and symmetric: More positive (negative) analyst preferences cause bigger decreases (increases) in policies; and positive and negative preferences cause changes in policies of opposite signs and with similar economic magnitudes. Our results are stronger for younger firms, for firms with higher market valuations, and for firms with more analyst attention. Overall our findings are consistent with the hypothesis that sell-side financial analyst preferences influence the corporate policies of the firms that the analysts cover.

We conjecture that firms try to accommodate analysts' preferences because of the pressure of analyst voice – companies may bow to pressure if the amount of criticism expressed by analysts becomes too much to bear – or because of the fear of analyst exit – i.e., losing coverage if analysts become too dissatisfied with the firm's policies. Losing analyst coverage can be costly

for firms. Kelly and Ljungqvist (2012) find that the loss of analyst coverage results in a decrease in liquidity and an increase in the cost of capital, which, as Derrien and Kecskés (2012) find, causes a decrease in investment and financing.

We perform several robustness tests. First, we rule out a potential mechanical relationship between estimated analyst preferences and future changes in corporate policies. For example, we address the concern that mean reversion in corporate policies might drive our results. We provide several pieces of evidence against such a mechanical relationship. We also provide evidence that our analysts' preferences are distinct from the preferences of the brokers for whom they work.

To the best of our knowledge, ours is the first paper to investigate the influence of analyst preferences on firm policies. Our study contributes to a stream of research on non-traditional determinants of a broad set of corporate policies. For example, Bertrand and Schoar (2003) and Graham, Li and Qiu (2012) find that managerial style explains a significant part of the variation in corporate policies and executive compensation, respectively; Cronqvist and Fahlenbrach (2009) find that blockholders similarly matter. Our contribution is to identify another influence on firm policies from a hitherto unexplored source: equity research analysts.

Our study also relates to the growing literature on catering (Baker and Wurgler (2011)). Examples of corporate policies guided by catering considerations include, among others: investment (Polk and Sapienza (2009)), mergers and acquisitions (Shleifer and Vishny (2003)), dividends (Baker and Wurgler (2004)), and growth vs. profits (Aghion and Stein (2008)). Relative to these articles our study differs in two ways. First, the audience to which firms cater – sell-side analysts – is firm-specific as opposed to market-wide. Second, in our context firms cater to financial intermediaries rather than directly to investors.

Finally, our paper also contributes to the recent literature on the effects of financial markets on the real economy. Some papers study how stock prices affect equity issuance (Khan, Kogan, and Serafeim (2012)), takeovers (Edmans, Goldstein, and Jiang (2012)), financing and investment (Grullon, Michenaud, and Weston (2011)). Derrien and Kecskés (2012) find that losses of analyst coverage result in less financing and investment for small firms.

The rest of this paper is organized as follows. Section I presents the methodology, sample, and data. Section II presents analyst preferences. Section III presents the effect of analyst preferences on corporate policies. Section IV presents robustness tests. Section V concludes.

I. Methodology, Sample, and Data

To test our hypothesis that analyst preferences affect corporate policies, we will proceed in two stages. First, we estimate analyst preferences. Second, we estimate the effect of these preferences on corporate policies. We will explain each of these stages in turn.

A. Estimating Analyst Preferences

We posit that analysts' coverage decisions reveal their preferences for corporate policies. Specifically, we assume that, on average, an individual analyst prefers the corporate policies of the firms that he or she covers compared to the corporate policies of the firms that he or she does not cover. By observing the patterns of initiations, continuations, and terminations of coverage by analysts, we infer their preferences for corporate policies.

By identifying analyst policy preferences in this way, we implicitly make several assumptions. First, we assume that analysts have some discretion as to which firms to cover. Second, we assume that corporate policies drive coverage decisions. McNichols and O'Brien (1997) argue that analysts choose to cover firms about which they hold positive views. We argue that analysts' views about firms are – at least in part— driven by corporate policies. Third,

although we recognize that analysts' policy preferences may vary across firms (e.g., an analyst may want Microsoft to start paying out dividends in 2002, but not Apple) or across time (e.g., an analyst may not want the firms covered to pay out dividends in 1990, but may want them to do so in 2003), we focus on the time- and firm-invariant component of their preferences.

The sample that we use to estimate analyst preferences is a panel of all analysts, years, and firms, i.e., the unit of observation is a firm-year-analyst triple. The sample of firms comprises all publicly traded U.S. operating firms between 1984 and 2009 in CRSP, Compustat, and I/B/E/S excluding financials and utilities. Analysts have little choice but to cover firms that are present in the S&P 500 index, so we exclude S&P 500 firms from the sample for the purpose of estimating analyst policy preferences.[5] To make sure that a few firms or years do not drive our analyst preference measures, we restrict the sample to those analysts who cover at least five firms per year for at least three years.

We define analyst coverage as follows: An analyst covers a firm during a year if that analyst has at least one earnings estimate for that firm during that year.

To estimate analyst preferences for a corporate policy, we use the following regression equation:

$$CPV_{it} = \alpha_i + \beta_t + \Gamma.\boldsymbol{COVERAGE}_{it} + \delta.\boldsymbol{X}_{i,t-1} + \varepsilon_{it} \quad (1)$$

where CPV_{it} is a corporate policy variable for firm i at year t, α_i is the fixed effect of firm i, β_t is the fixed effect for year t, $\boldsymbol{COVERAGE}_{it}$ is a $J \times 1$ vector of analyst indicators equal to 1 if analyst j covers firm i in year t and equal to zero otherwise, and $\boldsymbol{X}_{i,t-1}$ is a vector of lagged firm-level controls. The unit of observation *(j,t,i)* is an analyst-year-firm triple. The $1 \times J$ vector $\Gamma = \gamma_i$, where i=1,…, J is the analyst preference vector for that specific corporate policy. The control

[5] Our results are similar if we estimate preferences using both S&P 500 and non-S&P 500 firms.

variables are size, market-to-book, cash-flow-to-total assets, stock returns, and volatility; these variables are defined in Appendix Table I.

B. Estimating the Effect of Analyst Preferences on Corporate Policies

Our main hypothesis is that analysts' preferences influence the corporate policies of the firms that they cover. We test this hypothesis by looking at changes in corporate policies following exogenous drops in analyst coverage. We hypothesize that an analyst with a strong preference for a policy – say, high cash – induces the firms he or she covers to increase their levels of cash holdings. If the analyst drops coverage, all the firms previously covered by this analyst will exhibit smaller cash levels. In order to establish causality we need to be confident that the coverage drop is exogenous to corporate policies of all the firms previously covered: For example, we want to avoid situations in which the analyst bases his or her coverage decision on an expectation of future policies, or in which a common factor drives both coverage drops and corporate policies.

We consider two kinds of coverage drops that are plausibly exogenous to corporate policies. First, we consider all analyst disappearances from the I/B/E/S database. Such disappearances occur when an analyst retires or leaves the profession for another reason. Our sample of analyst disappearances includes 1,137 unique analysts (out of 1,811 analysts listed in I/B/E/S between 1984 and 2009) and 4,182 unique publicly traded U.S. operating firms, excluding financials and utilities, for a total of 15,158 analyst-year-firm observations between 1987 and 2009. The sample begins in 1987 because we require that analysts cover firms for at least three years. It ends in 2009 because we require one year with no analyst coverage to conclude that an analyst has disappeared. We deem that an analyst disappears in year t if he or she covers some firms in year t-1 and does not cover any firms in year t+1.

Second, we consider coverage drops following broker mergers or closures. Several recent papers use this approach to study the causal effects of analyst coverage (e.g., Hong and Kacperczyk (2010), Kelly and Ljungqvist (2012), and Derrien and Kecskés (2012)). To construct this sample, we use I/B/E/S to identify brokers that disappear between 1994 and 2008 following closures or mergers. In the case of closures, we then identify analysts who worked for the disappearing broker and have no earnings estimate in I/B/E/S for any firm during the year after the broker's disappearance date. In the case of mergers, for example between brokers A and B, we additionally determine that the disappearing broker-A analyst covered firms that were also covered by a broker-B analyst, so that the new entity had to fire one of the two redundant analysts. Given these constraints, our reduced sample comprises 60 unique analysts who disappear, 606 unique firms, and 747 analyst-year-firm observations. Because it is much smaller than the sample of analyst disappearances from the I/B/E/S database, this sample of coverage drops following broker mergers or closures is likely to produce much less precise estimates. On the other hand, it has the advantage of closely following the literature on the effects of drops in analyst coverage, and so provides evidence on the validity of our sample of I/B/E/S analyst disappearances. Whenever possible we carry out our analyses on both the large sample of analyst disappearances from I/B/E/S and on the small sample of analyst drops following broker mergers or closures. The size of the smaller sample precludes us from using it for cross-sectional analyses.

If analyst preferences affect corporate policies, firms should change their policies in the direction opposite to the preferences of the analyst who disappears. For example, firms covered by an analyst who prefers high *CAPEX* should decrease their *CAPEX* when the analyst disappears. To test this hypothesis, we run regressions of changes in corporate policies on the

preferences of analysts that disappear, as well as on control variables. We estimate the following regression equation:

$$CPV_{i,t+1} - CPV_{i,t-1} = \alpha + \beta.\gamma_j + \delta.\boldsymbol{X}_{i,t-1} + \varepsilon_{itj} \quad (2)$$

where $CPV_{i,t}$ is a corporate policy variable for firm i at year t, γ_j is the preference for analyst j that disappears in year t, and $\boldsymbol{X}_{i,t}$ is a vector of firm-level controls. The unit of observation (i,t,j) is a firm-year-analyst triple. The sample comprises only analysts who disappear and only the firms that they cover during the year before their disappearance. We expect β to be negative if, as we predict, firms change their policies in the direction opposite to the preference of the analyst who disappears.

We examine a range of policy variables that are studied in the corporate finance literature, including variables for: investment policies (capital expenditures and acquisitions); internal and external financing policies (debt and equity, as well as changes in cash holdings); R&D; payout policies; and leverage and cash holdings. We scale all policy variables by total assets. We measure corporate policy variables in excess of mean industry-year corporate policy variables. This allows us to control for industry-specific and time-specific factors affecting corporate policies. Moreover, since year t is the year in which we deem that an analyst disappears, we measure changes in corporate policies from year t-1 to year t+1. Appendix Table I provides the details of our variable construction.

Conceivably, mean reversion in our policy variables might generate a spurious finding of analyst influence on corporate policies. If a policy variable takes on high values before an analyst drops coverage of the firm, it will tend to generate a high estimated analyst fixed effect. After the coverage drop, the policy will tend to revert to the mean – but the coverage drop is not the cause of the change in policy. We address this concern in two ways. First, we control for the past level

of corporate policies (at year *t*-2).[6] Second, we perform a placebo test two years before the analyst disappears. If a mechanical relationship between analyst coverage drops and changes in corporate policies generates a spurious finding of analyst influence on corporate policies, then our results should also obtain two years before the analyst actually disappears.

The control variables that we use are: size, market-to-book, cash-flow-to-total assets, stock returns, and volatility. All variables are defined in Appendix Table I. Stock trading data are from CRSP, accounting data are from Compustat, and analyst data are from I/B/E/S. We winsorize all continuous variables at the 1st and 99th percentiles.

II. Analyst Preferences

[Insert Table I about here]

Before addressing our main research question – do analyst preferences influence corporate policies – we take a closer look at the analyst preferences estimated using Equation (1). Using our sample from I/B/E/S of 1,811 analysts working between 1984 and 2009, we first compare our estimated analyst preferences with simulated preferences obtained by randomly assigning analysts to firms, as follows. For every analyst, for every year, and for every industry covered by that analyst, we randomly assign firms to the analyst in such a way that the number of randomly assigned firms equals the true number of firms covered by that analyst in that industry. Firms covered by more analysts have a proportionately higher probability of being selected. After each random assignment, we compute analyst "preferences." We generate simulated analyst preferences through 1,000 iterations of this procedure.

[6] In untabulated analyses, we include several lags for corporate policies. Using several past levels of corporate policies captures a richer mechanical relationship between changes in corporate policies for a firm across time, but it also decreases the sample size significantly. Our results are similar when we include either one lag or several lags for corporate policies.

Table I presents various percentiles of the distribution of actual analyst preferences vs. simulated ones, as well as the results of Kolmogorov-Smirnov tests of equality of distributions. The Kolmogorov-Smirnov test rejects the null hypothesis of equality of distributions with high significance for all corporate policies. Figure 1 plots the distributions of actual and simulated preferences. Our results suggest that actual analyst preferences are markedly different from randomly generated ones.

We also check that analyst preferences are similar in the two samples we use: the sample of analysts disappearing from the I/B/E/S database, and the sample of analysts dropping coverage because of broker closures or mergers. Table I, Panel B, reports our results. Kolmogorov-Smirnov tests of equality of distributions confirm that the distributions of analyst preferences are similar in both samples.

[Insert Figure 1 about here]

In a second step, we attempt to uncover economic structure in analyst preferences by performing a factor analysis. While the interpretation of any factor analysis is necessarily subjective, five analyst preference factors emerge with a natural economic interpretation, with the first two being more statistically meaningful than the rest:

- a preference for share issuance and low debt;
- a preference for internal growth – i.e., high CAPEX – and debt increases;
- a preference for share issuance and cash buildup;
- a preference for high payout – i.e., high dividends and high share repurchase;
- a preference for external growth – i.e., acquisitions – and debt increases.

Table II, Panel A, contains the detailed results of our factor analysis.

[Insert Table II about here]

A similar picture emerges when we compute correlations between analyst preferences (Table II, Panel B) – e.g., preferences for share issuance and debt are strongly negatively correlated, and preferences for high dividends and high share repurchase are strongly positively correlated. Overall, Table II suggests that the analyst preferences estimated through Equation (1) have economic meaning.

III. Analyst Preferences and Corporate Policies

A. Descriptive Statistics

[Insert Figure 2 about here]

We begin by providing descriptive statistics for our sample. First, we count the number of analysts who disappear and firms that lose an analyst each year in our sample. Figure 2 presents the results: Panel A is the sample of analyst disappearances from I/B/E/S, and Panel B is the sample of coverage drops following broker mergers or closures. There is some clustering in calendar time, both in the analysts that disappear and in the firms that lose an analyst. In both samples there tends to be a below average number of coverage drops and firms losing an analyst in the early 1990s and an above average number in the early 2000s. However, such temporal clustering should not affect our results, because we measure changes in corporate policies for a given firm in a given year in excess of the mean change in corporate policies of firms in the same industry and the same year.

[Insert Table III about here]

Second, we examine the distribution of firm characteristics and of changes in corporate policies for firms affected by coverage drops. Table III presents the results. Panel A shows that our sample firms are large, both in terms of analyst coverage and market capitalization: The mean and median firm have analyst coverage of 15.4 analysts and 7.0 analysts, respectively, and

a market capitalization of $5.1 billion and $0.9 billion, respectively. The large average size of our sample firms is to be expected: Large firms tend to be covered by more analysts and are mechanically more likely to be affected by coverage drops.[7]

B. Corporate Policies After Coverage Drops: Analysis in Event Time

We start by plotting corporate policy changes after coverage drops. We compute mean corporate policies in event time for firms, conditional upon the preferences of the analyst who disappears. We label "positive" all analysts with preferences above the median, and "negative" all analysts with preferences below the median. In each preference group, we plot average corporate policies in each year, from three years before the analyst disappears to three years after.

[Insert Figure 3 about here]

Figure 3 presents the results. Between year -3 and year -1, corporate policies are roughly parallel for both the positive and the negative preferences groups. However, corporate policies change significantly between year -1 and year +1. Consistent with our hypothesis, policies generally increase during that period for the negative preferences group and decrease for the positive preferences group. In other words, the corporate policies of firms change in the direction opposite to the preference of the analyst who disappears. Moreover, between year +1 and year +3, corporate policies are roughly parallel for both the positive and the negative preferences group.

In summary, Figure 3 shows that corporate policies change quickly (as a function of analyst preferences) when an analyst disappears. Moreover, corporate policies change after an

[7] We replicated Table III for the sample of coverage drops following broker mergers and closures. Since the numbers are very similar, we do not report them in the interest of space.

analyst disappears and not before, consistent with analyst preferences having a causal effect on corporate policies.

C. Regression Analysis of the Effect of Analyst Preferences on Corporate Policies

We now turn to our main empirical analysis. We examine how analyst preferences affect corporate policies in a regression framework. To this end, we estimate Equation (2). We regress future changes in corporate policy variables on analyst preference variables, as well as on control variables.

[Insert Table IV about here]

Table IV presents the results.[8] Table IV, Panel A reports our results for the entire sample of analyst disappearances from I/B/E/S. Panel B restricts the sample to coverage drops due to broker closures or mergers. In Panel A, we find that changes in corporate policies are negatively related to analyst preferences for all corporate policies; we find the same in Panel B, except for R&D. In Table IV, Panel A, the coefficient on analyst preference is statistically significant at the 1% level for nine out of ten policies (for R&D, it is significant at the 5% level). In Table IV, Panel B, the coefficient on analyst preference is significant at the 5% level for five policies, and at the 10% level for one policy. Note that Panel B reflects about 1/20 as many observations as Panel A.

The findings of Table IV are consistent with our hypothesis that analyst preferences affect corporate policies. These results are economically significant. For example, a one-standard deviation change in analyst preferences is associated with a decrease in capital expenditures of roughly 0.3% of total assets, which for the average firm in our sample corresponds to almost $10

[8] In untabulated results we examine several alternative specifications. First, we include year fixed effects. Second, we use several past levels of corporate policies rather than just one. Finally, we split our sample period into the following roughly five-year subperiods: 1987 to 1990, 1991 to 1995, 1996 to 2000, 2001 to 2005, and 2006 to 2009. In all of these alternative specifications, our results are similar to the results in Table IV.

million. The economic magnitudes for other corporate policies range from -0.07% for dividends to -1.5% for cash buildup. Interestingly, the rank correlation between the economic significance of the various policies between our two samples is 0.94 (*p*-value 0.1%).[9]

A plausible concern is that our results might be driven by mean reversion in corporate policies. If a policy variable takes on high values right before an analyst drops coverage of the firm, that policy will tend to generate a high estimated analyst preference. After the coverage drop, the policy will tend to revert to the mean – but the coverage drop is not the cause of the change in policy. The fact that we control for mean reversion in our main specifications by including lagged values of the corporate policy variables under consideration should mitigate this concern. To further evaluate the severity of this issue, we run a placebo test in which we estimate Equation (2) two years before the actual disappearance of an analyst from I/B/E/S. If mean reversion were driving our results, and the mean reversion process had already started before the analyst dropped coverage, then in Equation (2) the coefficient on analyst preference should be negative. Table IV, Panel C, presents the results of this placebo test. The coefficient on analyst preference is negative for two policy variables, but it is not statistically significant, suggesting that mean reversion in policies is unlikely to drive our findings.[10]

D. Ruling Out a Spurious Correlation Between Coverage Drops and Corporate Policy Changes

A possible concern with our results is that analysts are more likely to disappear in bad economic times, which likely coincide with cuts in several of our policy variables (e.g., CAPEX, R&D, acquisitions, and payout). Under this scenario, we might be picking up a spurious

[9] While our results appear smaller than those of Bertrand and Schoar (2003) and Cronqvist and Fahlenbrach (2009), their empirical setup is very different from ours; as these authors are careful to note, their results may capture the endogeneity between the allocation of managers and blockholders to firms, respectively, and firms' policies.

[10] When we repeat this placebo test on our restricted sample of analyst disappearances caused by broker closures or mergers, we obtain the same results.

correlation between analyst preferences and changes in corporate policy: Policies might change after an analyst coverage drop, but not because of it. Rather, both the policy changes and the analyst coverage drops could be caused by the same factor: bad economic times.

A key prediction of our analyst influence hypothesis is that the influence of the analyst depends on the sign of his or her preference: Our results should be symmetric. If the analyst dropping coverage scored high on, e.g., dividend preference, we would expect a drop in dividends post-coverage drop. If, on the other hand, he or she scored low on dividends, we would expect an increase in dividends post-coverage drop. By contrast, if our results were simply due to a spurious correlation between coverage drops and a cut in policy variables in bad economic times, we should observe similar responses to coverage drops across analyst preferences: Our results would not be symmetric.

As a test, for each policy we create dummy variables for preference quintiles – $I_k(\gamma_j)$ equal to 1, if the analyst preference γ_j of analyst j falls in quintile k, and equal to zero otherwise (5: strong like; 1: strong dislike) – and estimate the following model:

$$CPV_{i,t+1} - CPV_{i,t-1} = \alpha + \sum_{k=1}^{5} \beta_k \cdot I_k(\gamma_j) + \nu \cdot X_{i,t-1} + \varepsilon_{i,t,j} \tag{3}$$

Table V reports our results. Consistent with the analyst influence hypothesis, corporate policies shift away from the preferences of the analyst dropping coverage. They increase if the analyst had a negative preference, and decrease if the analyst had a positive preference: The effect is symmetric. The symmetry of our results is inconsistent with an explanation based on a spurious correlation between coverage drops and shifts in policies due to a change in economic conditions.[11]

[11] Due to the small number of observations in our sample of coverage drops following broker closures or mergers, we only run this analysis and those of section III.E on our sample of analyst disappearances from I/B/E/S.

[Insert Table V about here]

Table V also finds that the analyst influence on policies is monotonic concerning the intensity of preferences: Stronger analyst preferences are associated with stronger policy shifts after the analyst drops coverage.

E. The Cross Section of Analyst Influence

Finally, we examine our results conditional upon various other analyst characteristics and firm characteristics.

First, an analyst's influence on corporate policies should be larger when his or her preferences are further away from the average preference of other analysts covering the firm. It should also be larger if fewer other analysts cover the firm. To capture these intuitions, we use a new independent variable: the change in the mean preferences of all analysts covering the firm between year t-1 and year t+1.[12] Our hypothesis predicts that, after an analyst disappears, firms change their corporate policies in the same direction as the change in the mean preference of all analysts. For example, if the analyst who disappears likes CAPEX more than the average analyst, then the average preference for CAPEX decreases after he or she disappears, which, in turn, should cause the firm to reduce its CAPEX.

[Insert Table VI about here]

Table VI, Panel A, presents the results of this analysis. They support the analyst influence hypothesis. Changes in corporate policies are positively related to changes in the mean preference of the analysts following the firm, consistent with our hypothesis that the preferences of a firm's analysts affect its choice of corporate policies.

[12] "All analysts" at year t-1 includes the analyst who disappears and excludes him or her at t+1. In computing this change, we hold the group of "other analysts" fixed: Except for the analyst who disappears, we assume that all analysts who cover the firm in year t-1 still cover it in year t+1. We do this to avoid the effect on mean preferences of endogenous decisions to initiate or terminate coverage of the firm between year t-1 and year t+1.

Second, we examine how our results depend on a firm's age. Younger firms tend to depend on external financing (Hadlock and Pierce (2010)), to be neglected by financial market participants, and to have more information asymmetry (Bhushan (1989), Brennan and Subrahmanyam (1995)). Analysts can alleviate these problems, and accordingly, young firms may be more willing to cater to the preferences of the analysts following them in order to avoid losing coverage.[13] We measure firm age as the number of years the firm has been publicly traded.

Similarly, the change in corporate policies should be larger for firms with better investment opportunities and higher valuations. Such firms are more likely to be overvalued, and analysts can be helpful in supporting a firm's stock price. We capture both investment opportunities and valuation using market-to-book.

Finally, the change in corporate policies should be larger for those firms to which the analyst who disappears has paid more attention. We capture analyst attention using the number of firms covered by the analyst who disappears.

We redo our results in Table IV conditional upon these various analyst and firm characteristics. Panels B, C, and D of Table VI present the results. Panel B shows that the interaction of analyst preferences and firm age is positive (for all ten corporate policies) and typically significant. In other words, our results are stronger for younger firms. Similarly, Panel C shows that the interaction of analyst preferences and market-to-book is typically negative (for eight out of ten corporate policies) and significant (for five of these). Put another way, our results are stronger for firms with better investment opportunities and higher valuations. Finally, Panel D shows that the interaction of analyst preferences and the number of firms covered by the

[13] Loughran and Ritter (2004) argue that analyst coverage is an important objective for IPO firms.

analyst is typically positive (for eight out of ten corporate policies) and significant. Thus our results are stronger for firms with more analyst attention.

We also examine whether our results are stronger for "star" analysts (based on *Institutional Investor* magazine), as Loh and Stulz (2011) would suggest. Surprisingly, we do not find results consistent with this hypothesis. This lack of results may potentially be due to reasons related to the endogenous matching process between firms and star analysts, to differences in the behavior of star analysts, or to the lack of incremental influence of star analysts on firms' corporate policies vs. non-star analysts.[14]

IV. Robustness Tests

We perform several robustness tests of our results. First, we examine whether our results are stronger when the mechanical relationship between analyst preferences and changes in corporate policies can be expected to be stronger. Specifically, we condition upon the length of the estimation period for analyst preferences. What may be happening is that analyst preferences for, e.g., CAPEX may be capturing an increase in CAPEX in the past, which, if CAPEX is mean reverting, will be associated with a decrease in CAPEX in the future. The association between past "analyst preferences for CAPEX" and future decreases in CAPEX should be stronger if "analyst preferences" are measured during a few years in the past rather than over many years in the past. We redo Table IV, adding a short estimation period dummy variable and the interaction of analyst preferences with this dummy variable. The short estimation period dummy variable

[14] First, analysts with influence, such as star analysts, may cover firms that are less subject to influence. Hence it is possible that, in equilibrium, the effect of star analysts on the firms that they cover is the same as the effect of non-star analysts on their firms. Second, the star status of an analyst, as it is conventionally measured, is determined by his or her popularity with institutional investors, who vote based on analysts' investment advice for money managers. Inasmuch as star status is not related to analysts' corporate policy advice for corporate managers, star analysts may have the same effect on corporate policies as non-star analysts. Finally, the analyst preferences that we examine may be determined primarily by irrational factors such as taste, rather than rational factors such as expertise. Star analysts may know this about their preferences and may weight them more lightly to the firms that they cover. Therefore, even if firms weight the preferences of stars more heavily, the net effect may be that star analysts have the same effect as non-star analysts.

equals one if the analyst preference estimation period is below the median; it equals zero otherwise.

Table VII, Panel A, presents the results. The interaction term is statistically significant for only two corporate policies, and for only one of these (cash holdings) are the results consistent with a mechanical relationship. Even in this one case, the effect of analyst preferences on corporate policies remains significant: The coefficient estimate is -18.8 in Table VII, Panel A, compared to -35.4 in Table IV or 47% smaller. Once again, taken as a whole, our results are inconsistent with a mechanical relationship between analyst preferences and changes in corporate policies.

In our final robustness test, we examine the possibility that our analyst preferences in fact capture the preferences of the broker for whom the analyst works. Brokers' preferences may be driven, for example, by the objectives of their investor clients and firm clients. This possibility is consistent with the results of Cronqvist and Fahlenbrach (2009), who find a correlation between specific institutional investors and specific corporate policies. We consider this possible explanation by adding broker fixed effects to our analysis. Table VII, Panel B, presents the results. For analyst preferences, the results are similar, both economically and statistically, to the results in Table IV. For broker preferences, the results are generally not significant economically or statistically. (When they are statistically significant, they have the wrong sign.)

V. Summary

We argue that equity research analysts have preferences for certain company policies. Previous research (McNichols and O'Brien 1997) suggests that these analysts choose to cover firms about which they can be positive. We posit that the analysts choose to cover companies whose policies they approve of, and also that they try to influence the policies of the companies

they cover. In our empirical design we infer analysts' policy preferences from their endogenous coverage decisions and test our hypothesis that analysts' preferences influence company policies using exogenous analyst coverage drops. We find that analysts do exhibit policy preferences, and that companies do appear to cater to the policy preferences of the analysts covering them: After an exogenous analyst coverage drop, company policies tend to move away from the preference of the analyst who dropped coverage. The influence of analyst preferences on company policies is economically significant, and is stronger for firms for which analyst coverage is likely to matter more: young firms, and firms with higher market valuations.

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Table I

Distribution of Analyst Preferences

This table presents the distribution of analyst preferences (mean, standard deviation, 25th, and 75th percentiles). Panel A compares the analyst fixed effects distribution in the sample of analyst disappearances from the I/B/E/S database (1,811 analysts between 1984 and 2009) with the simulated distribution. Panel B compares the analyst fixed effects distribution in the sample of analyst disappearances from the I/B/E/S database with analyst fixed effects distribution in the sample of analyst coverage drops following broker mergers or closures (60 analysts between 1994 and 2008). All variables are defined in Appendix Table I. The p-values are the p-values of the Kolmogorov-Smirnov test of the equality of distributions.

Panel A: Size distribution of the Analyst Fixed Effects

	Analyst Fixed Effects distribution				Simulated distribution					
	Mean	St Dev	P25	P75	Mean	St Dev	P25	P75	KS-test	p-value
CAPEX / TA	1.50%	1.18%	0.94%	1.93%	-2.70%	1.48%	-3.62%	-1.88%	0.902***	0.000
R&D / TA	0.73%	0.94%	0.28%	1.04%	-0.17%	0.80%	-0.56%	0.19%	0.553***	0.000
ACQN / TA	-2.63%	0.98%	-3.19%	-2.07%	0.21%	1.55%	-0.74%	1.21%	0.780***	0.000
Δ DEBT / TA	1.59%	0.78%	1.17%	1.99%	-0.47%	1.26%	-1.28%	0.32%	0.740***	0.000
EQUITY ISS / TA	0.85%	1.72%	-0.05%	1.71%	-0.31%	2.50%	-1.94%	1.31%	0.325***	0.000
DIV / TA	-0.06%	0.17%	-0.15%	0.02%	0.09%	0.16%	0.00%	0.17%	0.450***	0.000
SHARE REP / TA	-0.49%	0.75%	-0.94%	-0.11%	0.90%	0.77%	0.45%	1.34%	0.715***	0.000
Δ CASH / TA	-0.71%	1.43%	-1.48%	0.03%	-0.73%	2.69%	-2.50%	0.99%	0.178***	0.000
DEBT / TA	1.46%	2.90%	-0.33%	3.12%	0.29%	3.00%	-1.56%	2.20%	0.183***	0.000
CASH / TA	5.90%	2.53%	4.53%	7.18%	-1.77%	2.61%	-3.48%	-0.18%	0.881***	0.000

Panel B: Size distribution of the Analyst Fixed Effects in the large sample and restricted samples of exogenous analyst coverage drops

	Analyst Fixed Effects distribution (sample of analyst disappearances from I/B/E/S)				Analyst Fixed Effects distribution (sample of coverage drops following broker closures or mergers)					
	Mean	St Dev	P25	P75	Mean	St Dev	P25	P75	KS-test	p-value
CAPEX / TA	1.49%	1.11%	0.93%	1.94%	1.54%	0.79%	1.09%	1.98%	0.089	0.763
R&D / TA	0.75%	0.92%	0.30%	1.07%	0.67%	0.70%	0.28%	0.94%	0.160	0.109
ACQN / TA	-2.66%	0.98%	-3.24%	-2.17%	-2.57%	1.08%	-3.22%	-1.99%	0.080	0.858
Δ DEBT / TA	1.63%	0.82%	1.21%	2.05%	1.76%	0.80%	1.26%	2.20%	0.122	0.368
EQUITY ISS / TA	0.77%	1.75%	-0.14%	1.53%	0.92%	1.42%	0.13%	1.49%	0.150	0.152
DIV / TA	-0.04%	0.16%	-0.12%	0.03%	-0.04%	0.13%	-0.11%	0.03%	0.083	0.829
SHARE REP / TA	-0.45%	0.67%	-0.86%	-0.09%	-0.45%	0.71%	-0.88%	-0.15%	0.054	0.996
Δ CASH / TA	-0.78%	1.43%	-1.58%	-0.04%	-0.72%	1.07%	-1.31%	-0.23%	0.110	0.491
DEBT / TA	1.44%	2.70%	-0.18%	2.97%	1.40%	2.76%	-0.04%	2.97%	0.100	0.613
CASH / TA	5.88%	2.45%	4.59%	7.06%	5.71%	2.08%	4.65%	6.51%	0.118	0.411

Table II
Structure of Analyst Preferences

The sample comprises 1,811 analysts in I/B/E/S between 1984 and 2009. All variables are defined in Appendix Table I.

Panel A: Factor analysis of analyst preferences

This panel reports the factor loadings of corporate policies variables on the five factors that emerge from a factor analysis. The factors are ranked in decreasing order of importance in columns (1) to (5).

	Share issuance & low debt	Internal growth with debt increase	Equity issuance with cash buildup	High payout	External growth with debt increase
	(1)	(2)	(3)	(4)	(5)
CAPEX / TA	0.119	0.598	-0.038	-0.143	0.048
R&D / TA	0.180	0.124	-0.265	0.021	0.027
ACQN / TA	-0.109	0.008	0.015	-0.056	0.406
Δ DEBT / TA	-0.144	0.352	0.099	0.039	0.397
EQUITY ISS / TA	0.535	0.045	0.286	0.020	0.072
DIV / TA	0.162	-0.147	-0.081	0.416	-0.081
SHARE REP / TA	0.016	-0.258	0.015	0.420	0.060
Δ CASH / TA	0.092	-0.025	0.503	-0.037	0.052
DEBT / TA	-0.590	-0.152	0.096	-0.056	0.147
CASH / TA	0.489	-0.143	0.016	0.030	-0.073

Panel B: Correlations between analyst preferences.
***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

	CAPEX / TA	R & D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
CAPEX / TA	-									
R&D / TA	0.08***	-								
ACQN / TA	-0.04	-0.02	-							
Δ DEBT / TA	0.30***	0.03	0.25***	-						
EQUITY ISS / TA	0.11***	0.07***	0.02	-0.03	-					
DIV / TA	-0.14***	0.06**	-0.12***	-0.07***	0.06**	-				
SHARE REP / TA	-0.26***	-0.06**	0.00	-0.02	0.04	0.29***	-			
Δ CASH / TA	-0.05**	-0.17***	-0.03	0.09***	0.29***	-0.05**	-0.02	-		
DEBT / TA	-0.23***	-0.16***	0.12***	0.15***	-0.33***	-0.14***	0.00	0.03	-	
CASH / TA	-0.09***	0.05*	-0.09***	-0.12***	0.29***	0.12***	0.03	0.03	-0.33***	-

Table III
Descriptive Statistics

This table presents various descriptive statistics for firm characteristics and changes in corporate policies. The sample comprises 15,158 analyst-year-firm observations corresponding to 1,137 unique analysts disappearing from I/B/E/S and terminating coverage of all firms on their coverage list, and 4,182 unique firms between 1987 and 2009. The firms in the sample are publicly traded U.S. operating firms, excluding financials and utilities. All variables are defined in Appendix Table I. An analyst is deemed to disappear in year t if he or she covers some firms in year t-1 and does not cover any firm in year t+1. In Panel A, firm characteristics are measured at the year before the analyst disappears (t-1). In Panel B, changes in corporate policy variables are measured in excess of changes in mean industry-year corporate policy variables and are expressed as a percentage of total assets. They are measured from the year before the analyst disappears (t-1) to the year after (t+1).

Panel A: Firm characteristics
(sample of analyst disappearances from I/B/E/S)

	Analyst coverage	Market cap ($M)	Total assets ($M)	Market-to-book	Cash-flow-to-total assets	Stock returns	Volatility
Mean	15.4	5,151	3,281	3.59	5.9%	14.5%	53.1%
Standard deviation	11.0	14,781	7,943	3.93	17.6%	55.9%	26.8%
25th percentile	7.0	263	200	1.48	4.4%	-14.6%	33.4%
50th percentile	12.0	908	702	2.39	9.4%	12.5%	46.7%
75th percentile	22.0	3,141	2,402	4.03	14.2%	41.0%	65.3%

Panel B: Changes in corporate policies
(sample of analyst disappearances from I/B/E/S)

Changes in corporate policies in excess of changes in mean industry-year corporate policies (t-1 to t+1)

	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Mean	-0.25%	0.03%	-0.20%	-0.14%	0.80%	-0.01%	-0.01%	0.39%	0.57%	0.32%
Standard deviation	4.79%	5.92%	7.60%	8.29%	14.17%	1.14%	5.64%	16.39%	12.99%	11.79%
25th percentile	-1.81%	-0.66%	-0.91%	-0.94%	-0.47%	-0.04%	-0.81%	-4.17%	-5.04%	-3.68%
50th percentile	0.10%	0.00%	0.10%	0.01%	1.17%	0.00%	0.01%	0.72%	-0.72%	0.77%
75th percentile	1.67%	0.21%	1.26%	1.12%	4.43%	0.05%	0.89%	6.35%	4.45%	5.34%

Table IV
The Effect of Analyst Preferences on Corporate Policies

This table presents the results of regressions of future changes in corporate policies on past levels of analyst preferences. The regression equation is:

$$CPV_{i,t+1} - CPV_{i,t-1} = \alpha + \beta.\gamma_j + \delta.\boldsymbol{X}_{i,t-1} + \varepsilon_{itj}$$

where $CPV_{i,t}$ is a corporate policy variable for firm i at year t, γ_j is the preference of analyst j who disappears in year t, $\boldsymbol{X}_{i,t}$ is a vector of firm-level controls, and the unit of observation (i,t,j) is a firm-year-analyst triple. In Panel A, the sample comprises 15,158 analyst-year-firm observations, corresponding to 1,137 unique analysts and 4,182 unique firms between 1987 and 2009. The analysts in the sample disappear from the I/B/E/S database and terminate coverage of all firms on their coverage list. An analyst is deemed to disappear in year t if he or she covers some firms in year t-1 and does not cover any firms in year t+1. In Panel B the sample comprises 747 analyst-year-firm observations, corresponding to 60 unique analysts who disappear because of broker closures or broker mergers and 606 unique firms between 1994 and 2008. Panel C presents the results of a placebo test: The sample is the same as in Panel A, but we pretend that the analyst disappeared from I/B/E/S and dropped coverage two years before he or she actually did. The firms in the sample are publicly traded U.S. operating firms, excluding financials and utilities. All variables are defined in Appendix Table I. The economic magnitude of analyst preferences is computed as the effect of a one-standard deviation increase in the analyst preference variable and expressed as a percentage of total assets. Changes in corporate policy variables are measured in excess of changes in mean industry-year corporate policy variables and are expressed as a percentage of total assets. Levels of corporate policy variables are measured analogously. Changes in corporate policy variables are measured from the year before the analyst disappears (t-1) to the year after (t+1). Levels of corporate policy variables are measured at two years before the analyst disappears (t-2). Analyst preferences and control variables are measured at the year before the analyst disappears (t-1). Standard errors are clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

	Panel A: Changes in corporate policies in excess of changes in mean industry-year corporate policies (t-1 to t+1)									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Analyst preference	-23.72***	-29.49**	-73.42***	-67.71***	-81.35***	-37.64***	-70.78***	-111.09***	-34.69***	-35.43***
	(-4.89)	(-2.09)	(-8.96)	(-6.58)	(-6.92)	(-5.41)	(-8.10)	(-7.80)	(-6.84)	(-6.39)
Excess corporate policy (t-2)	-0.24***	0.01	-0.05***	0.02	-0.08***	-0.08***	-0.21***	0.18***	-0.16***	-0.15***
	(-17.96)	(0.65)	(-3.08)	(0.88)	(-5.42)	(-3.78)	(-7.02)	(6.80)	(-14.49)	(-16.16)
Size (t-1)	0.08***	-0.02	-0.15***	-0.06	-0.15**	0.01**	0.05	-0.16	0.03	0.15*
	(2.96)	(-0.48)	(-3.80)	(-1.26)	(-2.04)	(2.06)	(1.42)	(-1.42)	(0.26)	(1.67)
Market-to-book (t-1)	-0.07***	-0.08***	0.01	-0.05**	0.19***	-0.00	-0.07***	-0.00	-0.03	-0.02
	(-4.95)	(-3.25)	(0.67)	(-2.01)	(4.06)	(-0.61)	(-2.94)	(-0.04)	(-0.51)	(-0.40)
Cash-flow-to-total assets (t-1)	0.64*	3.01***	1.09**	0.09	-2.08	0.04	-0.19	-6.84***	-4.24***	-1.75
	(1.82)	(2.93)	(2.31)	(0.18)	(-1.23)	(0.86)	(-0.56)	(-3.17)	(-2.95)	(-1.38)
Stock returns (t-1)	1.26***	-0.00	0.06	0.59***	-2.73***	0.05**	0.92***	-2.28***	0.08	-1.37***
	(11.85)	(-0.03)	(0.41)	(3.46)	(-7.88)	(2.45)	(7.61)	(-4.92)	(0.30)	(-4.19)
Volatility (t-1)	-0.47**	2.25***	0.20	0.02	-0.21	-0.11**	0.04	-3.73***	-0.32	3.83***
	(-2.10)	(4.64)	(0.60)	(0.05)	(-0.31)	(-2.39)	(0.14)	(-3.23)	(-0.42)	(4.84)
Constant	0.12	-0.76	-1.31***	1.43***	3.38***	0.00	-0.26	3.62***	1.20	0.18
	(0.44)	(-1.58)	(-3.16)	(2.93)	(4.49)	(0.02)	(-0.79)	(2.99)	(1.32)	(0.20)
Observations	14,215	14,215	14,215	14,215	14,215	14,215	14,215	14,215	14,215	14,215
Adjusted R^2	0.108	0.014	0.013	0.006	0.037	0.018	0.047	0.041	0.048	0.078
Economic magnitude	-0.28%	-0.26%	-0.69%	-0.50%	-1.29%	-0.07%	-0.52%	-1.46%	-0.98%	-0.84%

Panel B: Using analyst disappearances caused by broker closures and broker mergers										
	Changes in corporate policies in excess of changes in mean industry-year corporate policies									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Analyst preference	-7.75	32.19	-67.42**	-47.09	-174.77***	-89.53***	-36.99	-184.25**	-60.83***	-47.29*
	(-0.34)	(1.03)	(-2.39)	(-1.22)	(-3.71)	(-3.01)	(-1.33)	(-2.44)	(-3.65)	(-1.72)
Control variables?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	707	707	707	707	707	707	707	707	707	707
Adjusted R^2	0.130	0.029	0.007	0.010	0.090	0.018	0.147	0.019	0.054	0.097
Economic magnitude	-0.09%	0.28%	-0.63%	-0.35%	-2.78%	-0.16%	-0.27%	-2.43%	-1.72%	-1.13%
Panel C: Placebo test two years before the analyst actually disappears (sample of analyst disappearances from I/B/E/S)										
	Changes in corporate policies in excess of changes in mean industry-year corporate policies									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Analyst preference	-0.87	-2.14	4.79	27.93***	11.35	12.56*	8.34	31.83**	14.32***	18.34***
	(-0.14)	(-0.16)	(0.44)	(2.75)	(0.83)	(1.78)	(0.93)	(2.16)	(2.85)	(2.84)
Economic magnitude	-0.01%	-0.02%	0.04%	0.21%	0.18%	0.02%	0.06%	0.42%	0.41%	0.44%

Table V

Ruling out a spurious correlation between coverage drops and corporate policy changes

This table presents the same regressions as Table IV, with one exception: Dummy variables for quintiles of analyst preferences are used instead of analyst preferences. The omitted dummy variable is the dummy variable for the third quintile of analyst preferences. Only selected results are tabulated.

	Changes in corporate policies in excess of changes in mean industry-year corporate policies									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Analyst preference quintile 5 (likes)	-0.28**	-0.29*	-0.96***	-0.95***	-2.53***	-0.03	-0.58***	-2.47***	-1.27***	-1.21***
	(-2.13)	(-1.71)	(-4.64)	(-3.92)	(-7.34)	(-1.07)	(-4.19)	(-5.63)	(-3.60)	(-3.76)
Analyst preference quintile 4	-0.08	-0.06	-0.38*	-0.35*	-0.24	0.01	-0.19	0.07	-0.84**	-0.25
	(-0.71)	(-0.59)	(-1.92)	(-1.69)	(-0.93)	(0.42)	(-1.61)	(0.21)	(-2.55)	(-0.90)
Analyst preference quintile 2	0.29***	0.00	0.48***	0.38*	0.23	0.04*	0.34**	0.67**	-0.01	0.20
	(2.78)	(0.00)	(2.67)	(1.90)	(0.92)	(1.66)	(2.52)	(2.05)	(-0.04)	(0.79)
Analyst preference quintile 1 (dislikes)	0.44***	0.39***	0.83***	0.32	0.57**	0.13***	0.60***	1.29***	1.46***	0.76***
	(3.86)	(2.91)	(4.35)	(1.56)	(2.08)	(4.54)	(4.50)	(3.54)	(3.93)	(2.81)

Table VI

The Effect of Analyst Preferences on Corporate Policies Conditional Upon Various Additional Analyst Characteristics and Firm Characteristics

Panel A presents the same regressions as Table IV, with one exception: The change in the mean of the preferences of all analysts following the firm is used instead of the preferences of the analyst who disappears. Panels B, C, and D present the same regressions as Table IV, with one exception: Analyst preferences are interacted with various conditioning variables. In Panel B, the conditioning variable is firm age, which is captured using the number of years the firm has been publicly traded. In Panel C, the conditioning variable is firm investment opportunities and valuation, both of which are captured using market-to-book. Firm age and market-to-book are measured as natural logarithms. In Panel D, the conditioning variable is analyst attention, which is captured using the number of firms covered by the analyst who disappears. All conditioning variables are measured at the year before the analyst disappears. Only selected results are tabulated.

Panel A: Changes in average analyst preference and changes in corporate policies

	Changes in corporate policies in excess of changes in mean industry-year corporate policies									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Change in the preferences of all analysts	72.44***	220.91***	249.67***	250.84***	244.09***	128.20***	231.59***	307.67***	223.31***	170.99***
	(2.61)	(2.82)	(5.56)	(5.15)	(3.53)	(3.91)	(5.44)	(4.54)	(8.52)	(5.68)
Control variables?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	13,038	13,038	13,038	13,038	13,038	13,038	13,038	13,038	13,038	13,038
Adjusted R^2	0.107	0.017	0.008	0.004	0.035	0.017	0.046	0.030	0.048	0.076

Panel B: Conditional upon firm age

	Changes in corporate policies in excess of changes in mean industry-year corporate policies									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Analyst preference	-63.97***	-60.82	-113.19***	-140.01***	-134.31***	-59.12***	-90.41***	-306.57***	-54.01***	-82.80***
	(-4.16)	(-1.55)	(-4.95)	(-5.13)	(-4.05)	(-3.39)	(-4.37)	(-6.64)	(-3.90)	(-5.12)
Firm age	-0.15*	-0.38***	0.69***	-0.22	-0.33**	0.00	-0.15**	0.75***	-0.28	-1.16***
	(-1.76)	(-3.15)	(2.72)	(-1.20)	(-2.24)	(0.07)	(-2.10)	(3.00)	(-1.45)	(-3.30)
Analyst preference × Firm age	15.96***	15.85	17.44**	29.26***	25.10**	8.28	8.75	90.65***	7.97*	21.10***
	(3.16)	(1.07)	(2.08)	(2.88)	(2.05)	(1.50)	(1.09)	(5.25)	(1.73)	(3.65)

Panel C: Conditional upon market-to-book

	Changes in corporate policies in excess of changes in mean industry-year corporate policies									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Analyst preference	-11.15	2.04	-80.57***	-73.11***	-59.83***	-10.76	-58.34***	-83.55***	-22.97***	-25.21***
	(-1.48)	(0.11)	(-7.08)	(-5.01)	(-3.65)	(-1.12)	(-4.51)	(-4.00)	(-3.23)	(-3.13)
Market-to-book	-0.00	-0.02	0.07	-0.09	0.24***	-0.01*	-0.08***	-0.05	0.01	0.14
	(-0.07)	(-0.73)	(1.00)	(-1.42)	(4.43)	(-1.71)	(-2.67)	(-0.67)	(0.15)	(1.32)
Analyst preference	-4.64**	-6.31**	2.15	1.84	-4.96	-9.13***	-3.69	-6.93*	-3.24**	-2.55
× Market-to-book	(-1.99)	(-2.16)	(0.91)	(0.55)	(-1.39)	(-2.62)	(-0.93)	(-1.73)	(-2.01)	(-1.41)

Panel D: Conditional upon analyst attention

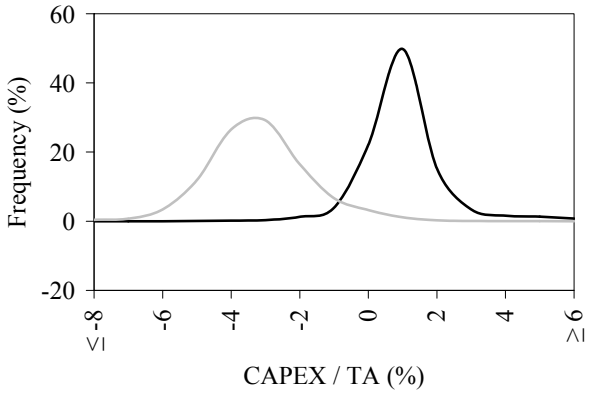
	Changes in corporate policies in excess of changes in mean industry-year corporate policies									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Analyst preference	-69.42***	-145.60*	-44.03	-195.98***	-213.45***	-124.42***	-155.51***	-126.15	-28.49	-120.57***
	(-2.68)	(-1.85)	(-0.84)	(-3.98)	(-2.89)	(-3.87)	(-3.29)	(-1.60)	(-0.98)	(-3.77)
Analyst attention	-0.14	-0.28	-0.24	-0.74**	0.43**	-0.01	-0.00	0.67*	0.14	-1.49**
	(-1.04)	(-1.55)	(-0.45)	(-2.46)	(2.07)	(-0.63)	(-0.00)	(1.95)	(0.50)	(-2.30)
Analyst preference	16.23*	42.58	-10.73	46.15***	49.97*	31.25***	31.23*	5.72	-2.28	31.63***
× Analyst attention	(1.86)	(1.50)	(-0.57)	(2.68)	(1.86)	(2.84)	(1.88)	(0.20)	(-0.22)	(2.74)

Table VII
Robustness Tests of the Effect of Analyst Preferences on Corporate Policies

This table presents the same regressions as Table IV, with the following exceptions for each panel. In Panel A, analyst preferences are interacted with a short estimation period dummy variable, and this interaction variable is used as a control variable alongside the short estimation period dummy variable. The short estimation period dummy variable equals one if the analyst preference estimation period is below the median; it equals zero otherwise. In Panel B, a control variable for broker preferences is also used. Only selected results are tabulated.

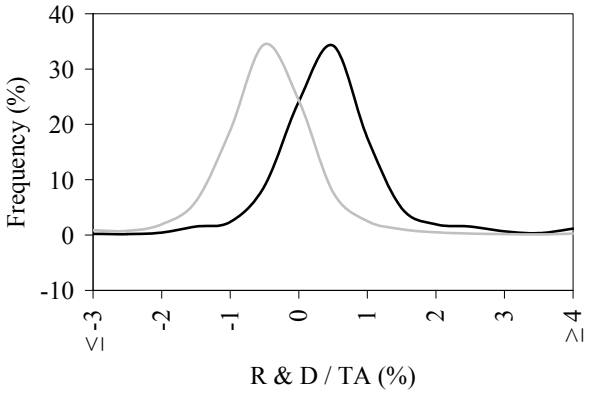
Panel A: Conditional upon preference estimation period length										
	Changes in corporate policies in excess of changes in mean industry-year corporate policies									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Analyst preference	-26.23**	-33.74*	-53.08***	-42.54**	-107.93***	-40.01**	-78.86***	-119.43***	-55.80***	-18.83**
	(-2.55)	(-1.70)	(-3.57)	(-2.41)	(-5.50)	(-2.57)	(-4.73)	(-4.23)	(-6.84)	(-2.11)
Short estimation period	0.08	0.12	-0.85*	0.60*	-0.64***	0.03	0.15	-0.58	-0.32	1.00*
	(0.44)	(0.65)	(-1.73)	(1.67)	(-2.98)	(1.62)	(1.26)	(-1.49)	(-1.19)	(1.70)
Analyst preference	2.84	5.31	-28.01	-32.49	37.05	3.12	11.99	11.17	28.93***	-23.47**
× Short estimation period	(0.24)	(0.21)	(-1.63)	(-1.54)	(1.57)	(0.20)	(0.65)	(0.35)	(3.07)	(-2.32)
Panel B: Analyst preferences separate from broker preferences										
	Changes in corporate policies in excess of changes in mean industry-year corporate policies									
	CAPEX / TA	R&D / TA	ACQN / TA	Δ DEBT / TA	EQUITY ISS / TA	DIV / TA	SHARE REP / TA	Δ CASH / TA	DEBT / TA	CASH / TA
Analyst preference (A)	-27.63***	-32.09**	-72.67***	-66.71***	-86.50***	-42.09***	-70.17***	-107.77***	-35.48***	-35.65***
	(-5.34)	(-2.16)	(-8.46)	(-5.93)	(-7.23)	(-5.19)	(-7.56)	(-7.31)	(-6.81)	(-6.30)
Broker preference (B)	32.00***	28.19	-6.99	-6.40	48.31*	23.81*	-4.25	-39.22	6.82	2.55
	(2.89)	(1.33)	(-0.27)	(-0.24)	(1.91)	(1.73)	(-0.22)	(-1.12)	(0.62)	(0.17)
Economic magnitude of (A)	-0.32%	-0.28%	-0.68%	-0.49%	-1.38%	-0.07%	-0.51%	-1.42%	-1.00%	-0.85%
Economic magnitude of (B)	0.17%	0.08%	-0.03%	-0.02%	0.31%	0.02%	-0.01%	-0.16%	0.08%	0.02%

Panel A: Capital expenditures



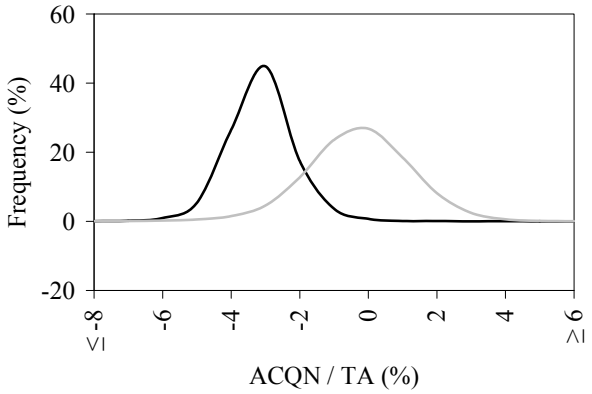
CAPEX / TA (%)

Panel B: Research and development expenditures



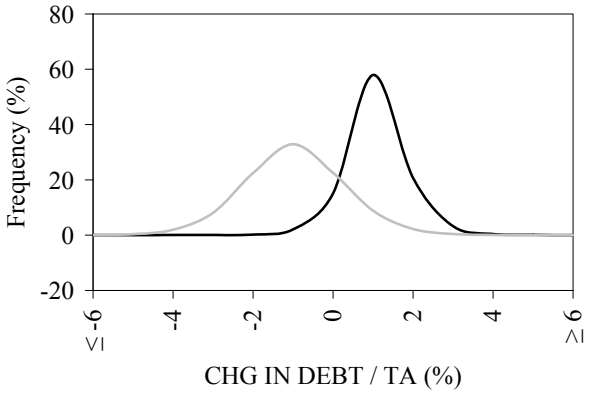
R & D / TA (%)

Panel C: Acquisitions expenditures



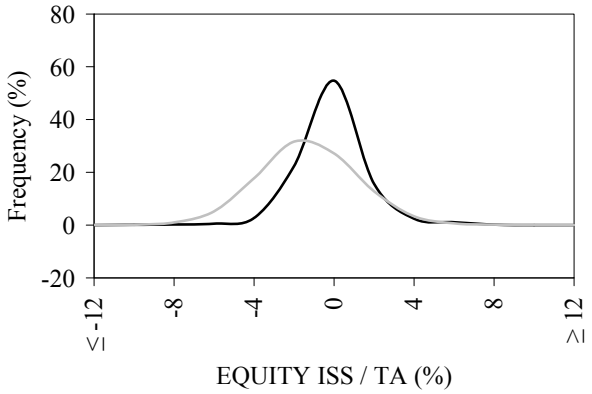
ACQN / TA (%)

Panel D: Change in debt



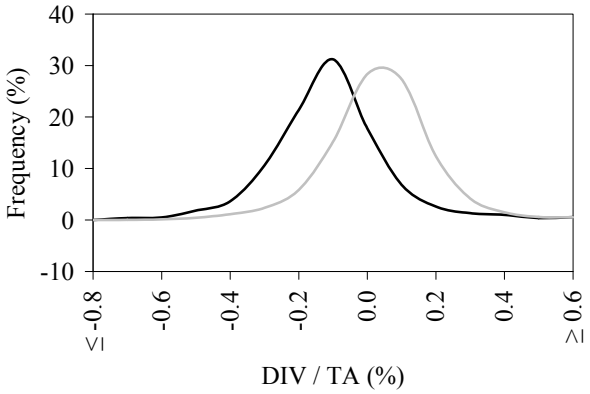
CHG IN DEBT / TA (%)

Panel E: Equity issuance



EQUITY ISS / TA (%)

Panel F: Dividends



DIV / TA (%)

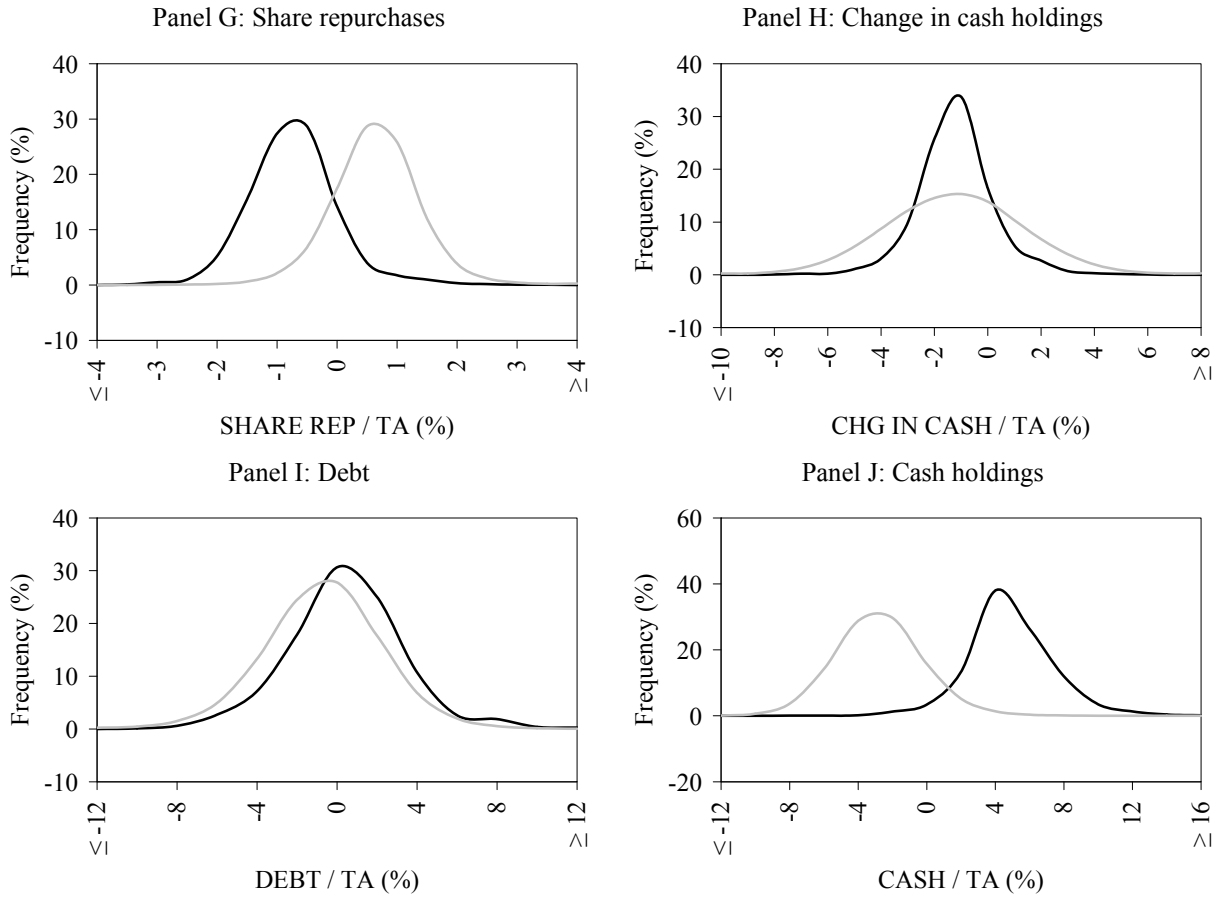
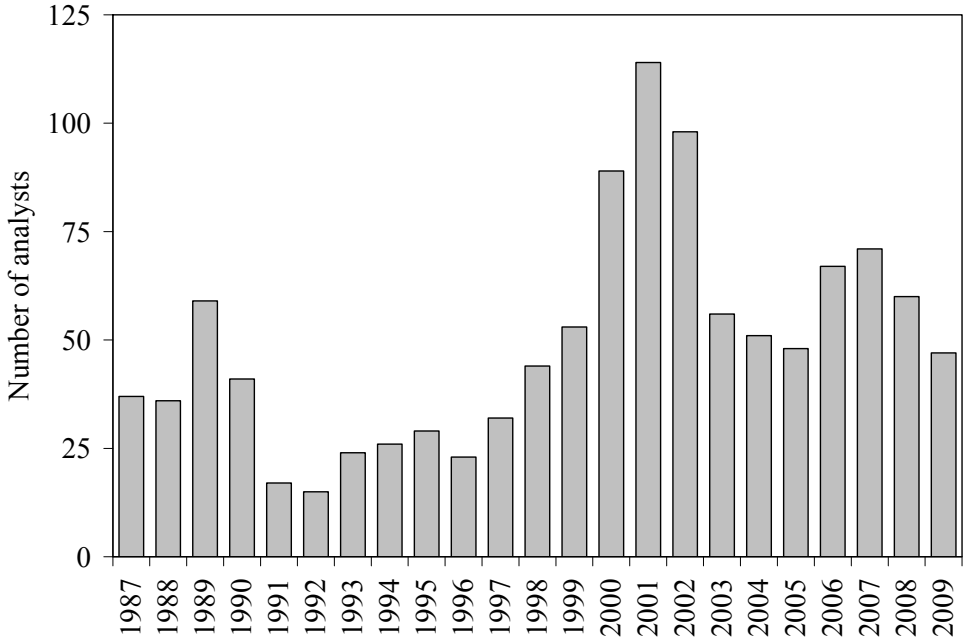
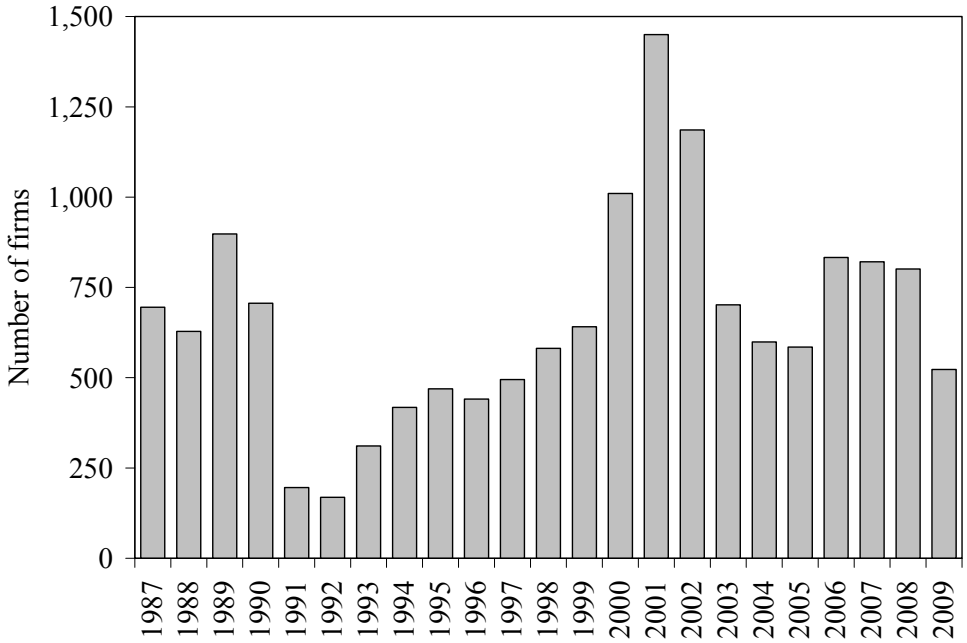


Figure 1. The distributions of true and simulated analyst preferences for corporate policies. This figure presents the true distribution of analyst preferences (dark line) for corporate policies, as well as the distribution of simulated preferences (light line). The analysts in the sample are 1,811 analysts between 1984 and 2009. All variables are defined in Appendix Table I.

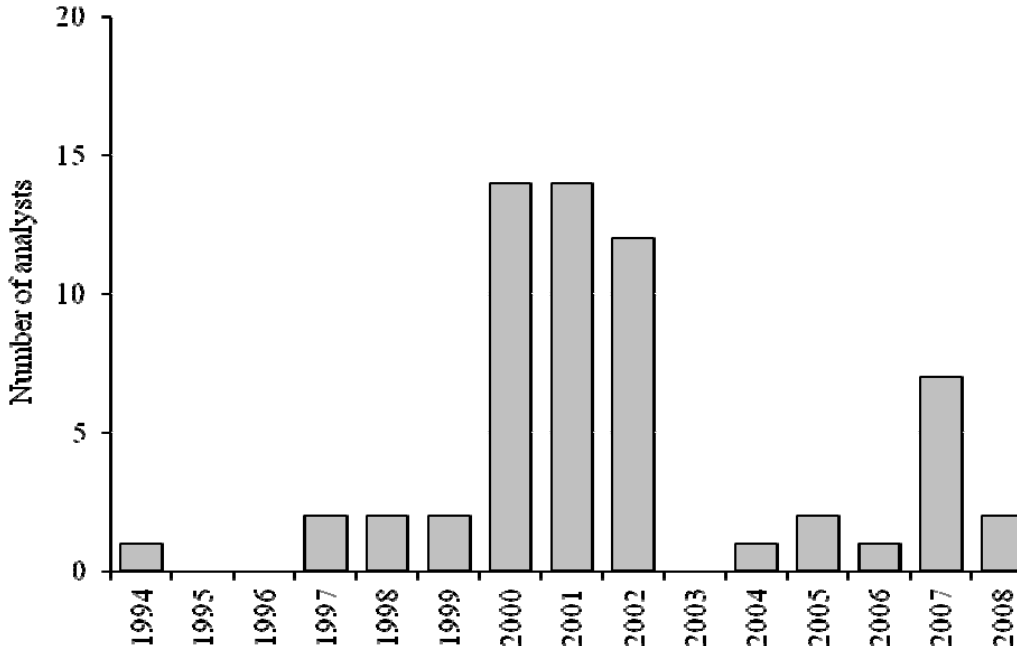
Panel A: The distribution in calendar time of analysts who disappear



Panel B: The distribution in calendar time of firms that lose an analyst



Panel C: The distribution in calendar time of analysts who disappear (sample of coverage drops following broker mergers or closures)



Panel D: The distribution in calendar time of firms that lose an analyst (sample of coverage drops following broker mergers or closures)

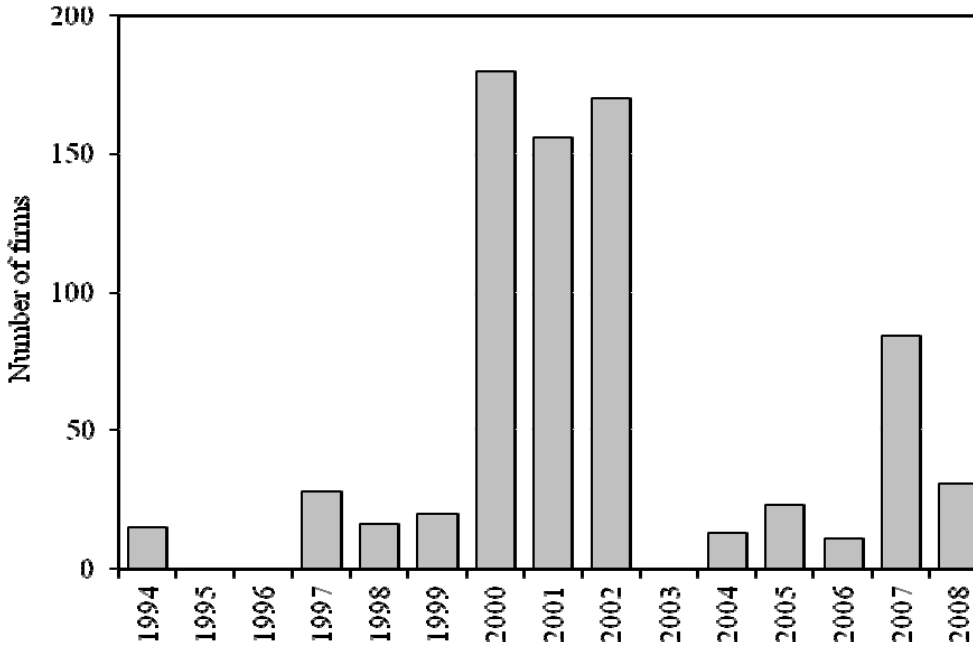
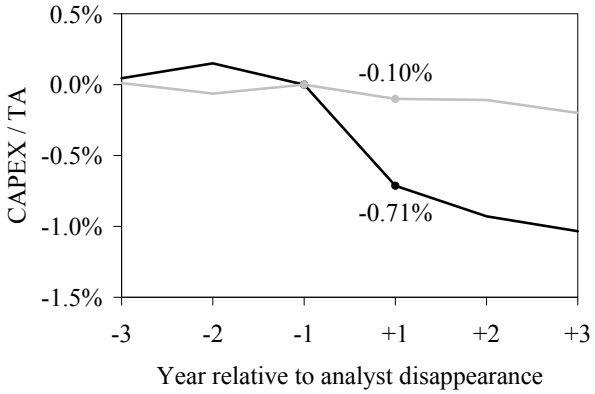
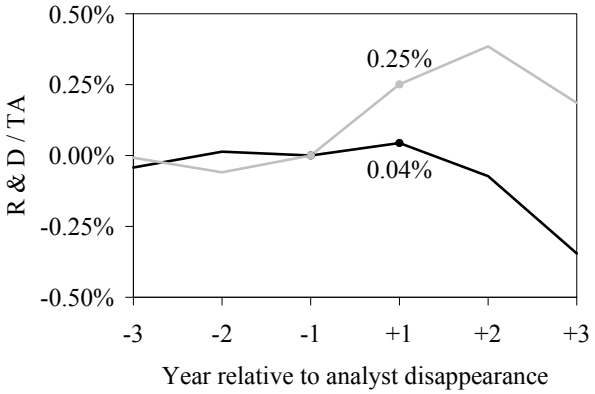


Figure 2. The distribution in calendar time of analysts who disappear and firms that lose an analyst. This figure presents the distribution of analysts and firms in the sample in calendar time. In Panels A and B, the sample includes 15,158 analyst-year-firm observations corresponding to 1,137 unique analysts who disappear from I/B/E/S, and terminate coverage of all firms on their coverage list, and 4,182 unique firms between 1987 and 2009. The firms in the sample are publicly traded U.S. operating firms, excluding financials and utilities. In Panels C and D, the sample includes 747 analyst-year-firm observations, corresponding to 60 unique analysts who disappear because of broker closures or broker mergers and 606 unique firms between 1994 and 2008.

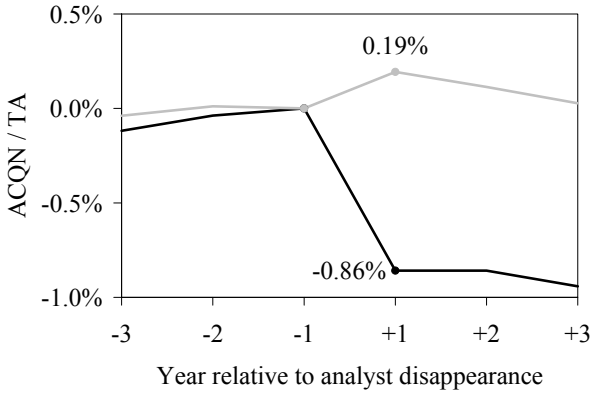
Panel A: Capital expenditures



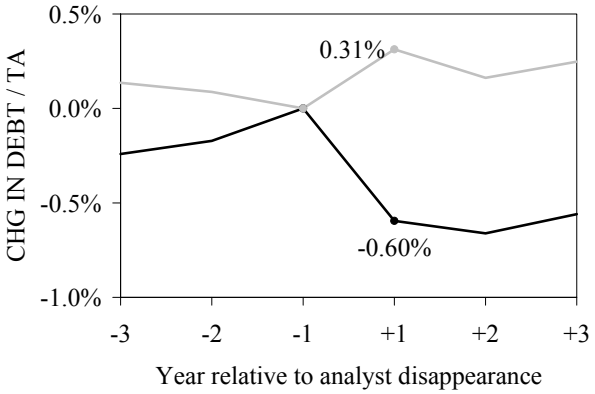
Panel B: Research and development expenditures



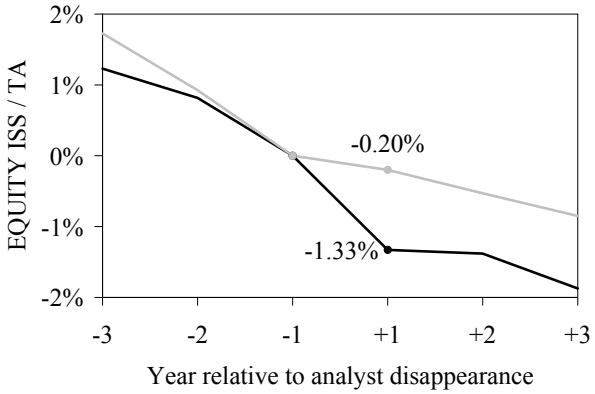
Panel C: Acquisitions expenditures



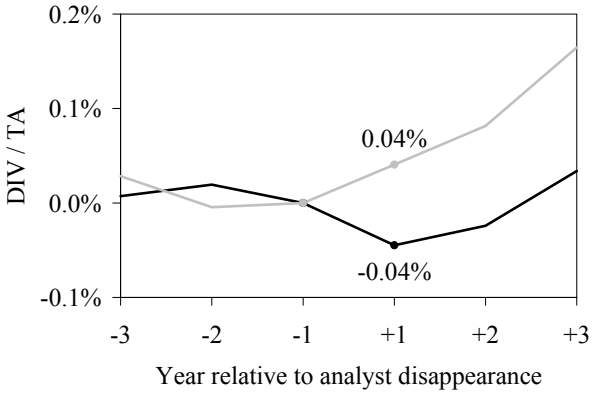
Panel D: Change in debt



Panel E: Equity issuance



Panel F: Dividends



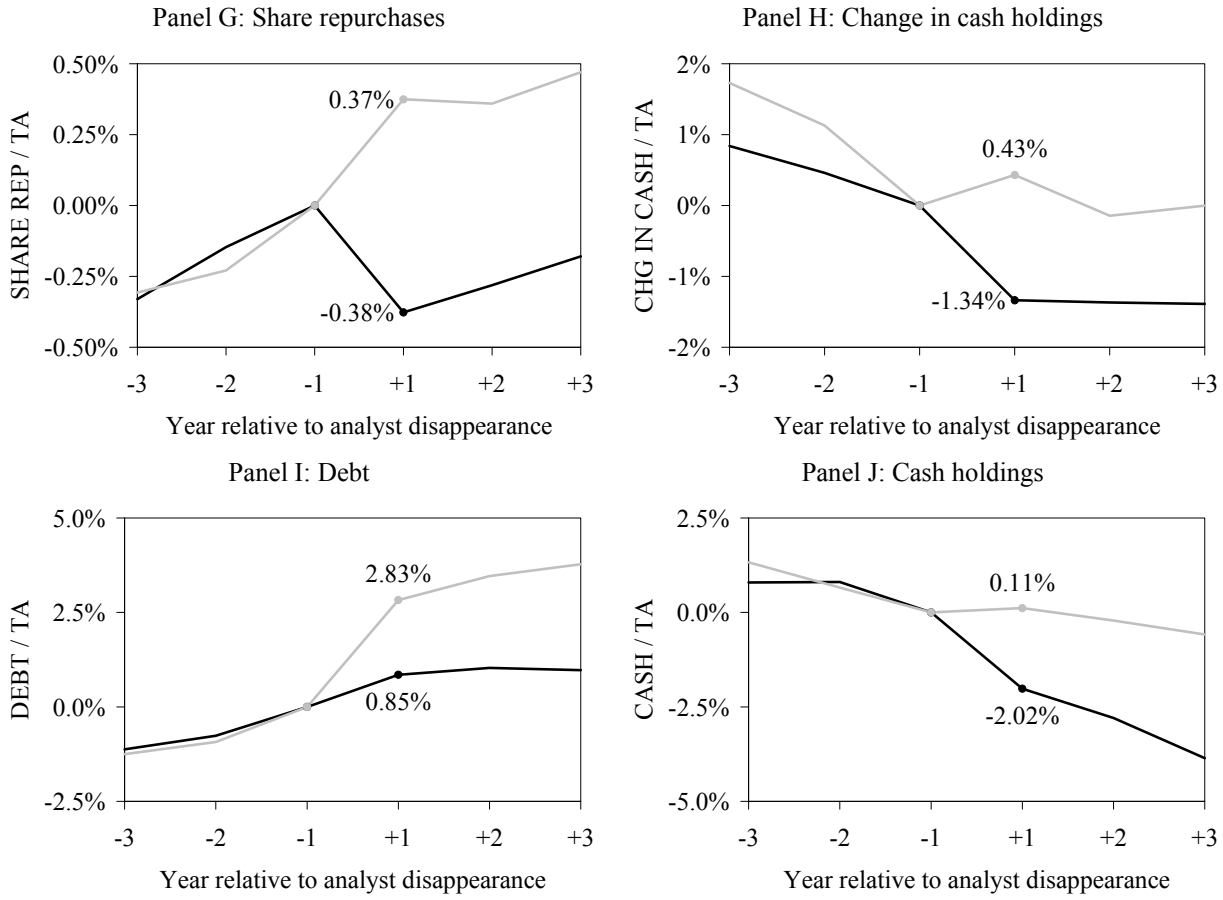


Figure 3. Corporate policies in event time for firms with positive analyst preferences and for firms with negative analyst preferences. This figure presents mean corporate policies in event time for firms with positive analyst preferences (dark line) and for firms with negative analyst preferences (light line). The sample comprises 15,158 analyst-year-firm observations corresponding to 1,137 unique analysts and 4,182 unique firms between 1987 and 2009. The analysts in the sample disappear and terminate coverage of all firms on their coverage list. The firms in the sample are publicly traded U.S. operating firms, excluding financials and utilities. Separately for positive and negative analyst preferences, corporate policies are adjusted so that they equal zero at the year before the analyst disappears. For each corporate policy, analysts who disappear with preferences above the median are classified as analysts with positive preferences, and analysts who disappear with preferences below the median are classified as analysts with negative preferences. Analyst preferences are measured at the year before the analyst disappears. All variables are defined in Appendix Table I.

Appendix Table I
Variable Definitions

This table presents variable definitions. Corporate policies are measured in excess of mean industry-year corporate policies, except for analyst preferences. Industry is defined using two-digit SIC codes. * indicates that the variable is defined using Compustat data items.

Panel A: Corporate policy variables, control variables, and other variables	
Name	Definition
Corporate policy variables	
- CAPEX / TA or capital expenditures	CAPX/AT *
- R&D / TA or research and development expenditures	XRD/AT *
- ACQN / TA or acquisitions expenditures	AQC/AT *
- Δ DEBT / TA or change in debt	(DLCCH+DLTIS-DLTR)/AT *
- EQUITY ISS / TA or equity issuance	SSTK/AT *
- DIV / TA or dividends	DV/AT *
- SHARE REP / TA or share repurchases	PRSTKC/AT *
- Δ CASH / TA or change in cash holdings	CHECH/AT *
- DEBT / TA or debt	(DLC+DLTT)/AT *
- CASH / TA or cash holdings	CHE/AT *
Control variables	
- Size	ln(AT) *
- Market-to-book	(PRCC_F*CSHO)/(TXDITC CEQ) *
- Cash-flow-to-total assets	(IB+DP)/AT *
- Stock returns	Annualized daily stock returns
- Volatility	Annualized standard deviation of daily stock returns
Other variables	
- Analyst coverage	Number of analysts covering a firm
- Market capitalization	PRCC_F*CSHO *
- Firm age	Number of years the firm has been publicly traded

Panel B: Analyst preferences variables

- Analyst preferences: The sample is the same panel of analysts, years, and firms as above. The corporate policy is regressed on analyst fixed effects, year fixed effects, firm fixed effects, and lagged control variables. Analyst fixed effects are dummy variables that equal one for a given analyst, for a given firm, and for a given year, if that analyst covers that firm in that year; they equal zero otherwise. The control variables are size, market-to-book, cash-flow-to-total assets, stock returns, and volatility. The resulting coefficient estimates on the analyst fixed effects are the fixed effects analyst preference for that corporate policy.

- Simulated analyst preferences: For every analyst, for every year, and for every industry covered by the analyst, firms are randomly assigned to the analyst such that the number of randomly assigned firms in the industry equals the number of true firms covered by the analyst in that industry. Firms covered by more analysts have a proportionately higher probability of being selected. After each random assignment, analyst preferences are computed. Simulated analyst preferences are generated through 1,000 iterations of this procedure.

- Broker preferences: For every broker, the mean of the preference for the corporate policy is computed across all analysts working for that broker. The resulting mean is the broker preference for that corporate policy.

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