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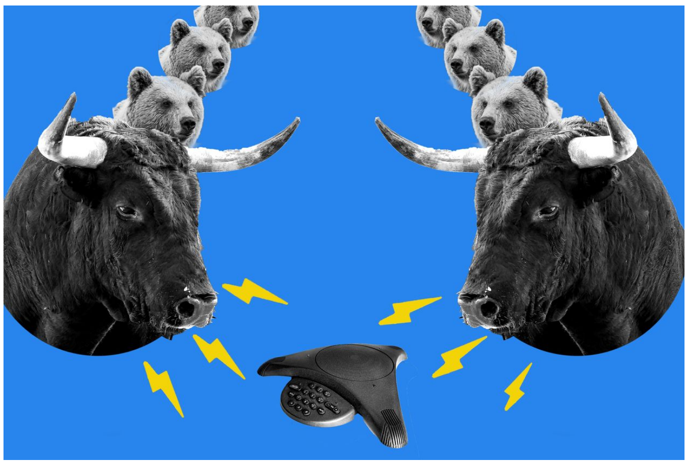
When Companies Favor Bullish Analysts on Calls, Bad News Often Follows

One or two quarters after such earnings calls, stocks of the companies have tended to fall on negative news, a study found.



Calling only on bullish analysts during earnings calls doesn't violate SEC rules, but seems to go against other guidelines.

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By Cheryl Winokur Munk

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Beware of companies that disproportionately call on bullish analysts to speak during earnings conference calls. They tend to later reveal negative news that drives down their share price.

That correlation—detailed in a recent study—can be valuable for investors, says Lauren Cohen, the L.E. Simmons professor in the finance and entrepreneurial management units at Harvard Business School, who co-wrote the study.

In the calendar quarters from 2003 through the first quarter of 2015, 17% to 22% of companies in the U.S. heavily favored bullish analysts on their earnings calls, according to the study, which was published in the April edition of the journal Management Science. The researchers found that the stocks of these companies tended to fall on negative news one or two quarters after these earnings calls.

Armed with this knowledge, an investor could use transcripts of a company's earnings call to determine whether bullish analysts were favored—based on the published ratings of the company by the analysts who spoke during the call—and if they apparently were favored, short the stock, says Dr. Cohen.

Calling only on bullish analysts during earnings calls—or cutting off analysts whose questions broach subjects that executives don't want to address—doesn't violate Securities and Exchange Commission rules on the sharing of corporate information. "There's no obligation to be democratic on an earnings call," says David Axelrod, a former SEC litigator who is now a partner at the law firm Ballard Spahr LLP. "In fact, there's no obligation to have earnings calls to begin with."

However, focusing on bullish analysts seemingly flies in the face of nonbinding guidelines published in 2004 by the CFA Institute, a nonprofit global association of investment professionals, and the National Investor Relations Institute, an association of investor-relations professionals. "Companies must not discriminate among analysts based on their prior research, opinions, recommendations, earnings estimates or research conclusions," the guidelines state.

When companies discriminate among analysts, such as picking only their cheerleader analysts to speak on earnings calls, it does investors a disservice, says Jim Allen, head of Americas capital-markets policy at the CFA Institute. If questions are curbed, investors don't have the full picture on which to base their investment decisions, he says.

If investors wanted to force companies to adopt more-democratic processes for earnings calls, they could push for it. But it would take pretty significant collective action, says Mr. Axelrod, the attorney. "To really force companies to change their practices, you'd have to establish such a significant momentum among shareholders. It just seems unlikely. Investors care about other things more deeply," he says.

But even without pressure from shareholders, there are some constraints on the practice because of the potential drawbacks for companies, Dr. Cohen says. Notably, analysts who are consistently frozen out during earnings calls are likely to eventually drop coverage, which could help keep companies from acting this way repeatedly, he says. Broader recognition of the practice is also likely to have a chilling effect, Dr. Cohen says.

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