EXECUTIVE SUMMARIES

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Do Analysts Overweight Earnings Information?

One large part of a financial analyst's duties, is to forecast future earnings of the firm under coverage. As a benchmark for her forecasts the analyst uses past earnings and earnings development, amongst other input factors. Prior empirical research on financial analyst earnings forecasts has documented both analysts' overreaction and underreaction to past earnings. In contrast to previous studies, this study tries to establish a pattern in the financial analysts' overreaction and underreaction based on how past reported earnings and earnings growth have developed, i.e. how the earnings path is shaped.

The financial analysts' earnings per share forecast data used in the study is provided by the Institutional Brokerage Estimate System (I/B/E/S). The empirical tests are conducted on the four Nordic countries, Denmark, Finland, Norway and Sweden during 1990–2000. I have used 91 089 individual analyst earnings forecasts to calculate 14 794 consensus forecasts for 944 Nordic firms.

This study sets out to examine how analysts utilize past financial statement information to form their future expectations for the firms they cover. Prior research has investigated how the change in past earnings, or the first derivative of the reported earnings per share, impacts the forecast error. The results are somewhat contradictory and support both overreaction and underreaction to the prior year's earnings change. Using data for the Danish, Finnish, Norwegian and Swedish markets I present some evidence that analysts overreact to past change in earnings, measured as the first derivative of reported earnings per share. However, as prior research has shown that the analysts overreact or underreact to recent changes in earnings, this study establish a link between the direction of earnings paths and the financial analysts' overreaction / underreaction. The earnings paths are measured as the second derivative of past reported earnings per share. The empirical results on the Nordic markets show that the sign of the second derivative impacts the direction of the consensus forecast error. Implying that analysts overweight past earnings information as they overreact or underreact to recent earnings information depending on the direction of the shift in earnings paths. Rephrased, financial analysts are likely to fall behind the curve in case of a shift in earnings paths. As financial analysts tend to overweight past earnings information it implies that when the true estimation model require more weight on other information than past earnings, analysts are likely to estimate with less accuracy. I also examine the four Nordic countries separately and present similar results as for the total Nordic sample. Furthermore, Nordic firms reporting a loss are associated with a larger forecast error than non-loss firms, as already pointed out by prior research on US data. ■