

**Market scenes and the construction of calculable space**  
- an essay on financial analysis

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*Résumé*

Still quaking after the late boom and bust in IT-shares, it is close at hand to liken the stock market to a drama with a continuously postponed conclusion. Top managers are forced to be skilled actors and lead the play forward by narrating company stories and dramatize market events. Against this background, attention is called to the role of the financial analyst. Neither being any of the leading characters nor being part of the trading audience, this role is a puzzling problem that eludes the script of financial theory. Perhaps the most apparent implication of the dramatic context is to view the financial analyst as a critic. As such, the analyst evaluates the performance of the main actors; is management convincing, and more importantly, are they trustworthy? But, as the drama unfolds and analysts get the opportunity to speak, the script falls apart and alters into props and scenery. Formerly a silent messenger between actors and audience – a pure mechanism – the analyst reveals himself under the jester's hood. By constantly questioning the plot, the characters and the frame, the jester is the inventor of new interpretive schemes that puts calculable spaces into movement. By displacing frontiers that separates the reckonable and controllable with the unknown and ambiguous, the financial analyst creates new frames and becomes an active creator of market trade.

## *The drama*

One of the spicy details discovered in the messy remains of the notorious American energy-giant, was the dummy trading room constructed to impress investors. In 1998, when the new project Enron Energy Service was launched, a conference for analysts following the company was arranged. To get the right image of the vigorous activities within the young stock market comet, the attendants was guided through a gigantic hall of flickering computer screens, loud traders and ringing telephones. That there was nothing behind the scene was not exposed until after the collapse and a couple of former employees in an act of vengeance decided to uncover the scam. The operation had an internal cover-name, the Sting, after the classic gangster movie from 1973, where a phony bookmaker shop played a central role.

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The stock market manifests itself in varying guises, or scenes – such as the analyst conference above, a computer screen or an annual report – that all make informational claims. The labour of detecting these scenes, define what their frames disclose and hide and finally interpret their meaning, is another way of describing the investment decision process. Considering companies accelerating ambitions to take charge of these scenes by presenting themselves in well-directed manners, the dramatic qualities of the stock market becomes apparent. Under the intense media coverage, the role of the top manager takes a skilled actor that always has to be prepared to narrate the company story to the investing public. This dramatizing of events is also the staging of information, where some issues get a more prominent status at the expense of others. Thus, the dramatic features of the stock market have clear implications for the vital production and consumption of information. But the drama also provides a background against which to compare the organization and workings of the market institution as a whole.

Exploring the workings of financial markets through such a theatrical lens is perhaps an unconventional approach – at least if you consider standard financial literature. However, a glance outside the academic text exposes an approach with a long tradition. Financial markets and their inmates were a popular theme in comedies, pamphlets, novels and vaudeville acts in the 18<sup>th</sup> century England and France. The operations of the marketplace was for a long time connected with deep suspicion by a general public that commonly dispatched the mysterious financial logic as hocus-pocus and even sorcery (Preda, 2000). An obvious reason for the odd and comic qualities found in financial markets is the fact that the number of people who were

directly dependent on them for a livelihood was limited to a few within a narrow elite. This provides a blaring contrast to today's central position of the stock market in both the public sphere and individual life-worlds. Nevertheless, as I will try to show, the theater might still be of use to explore the workings of the market and in particular its inhabitants.

The basic idea that provides the most obvious foundation of a dramatic perspective has been formulated by the market ethnographer Mitchel Abolafia as "*markets are not spontaneously generated by the exchange activity of buyers and sellers. Rather, skilled actors produce institutional arrangements: the rules, roles, and relationships that make market exchange possible.*" (Abolafia, 1996, p. 9) The drama is helpful as it provides analytical categories such as role, actor, scene, act, audience as well as their internal relations.<sup>1</sup> As the topic of this essay concerns financial analysts, the most central of these categories will be the actor and the role. But as these concepts would have negligible meaning without their relations to the kindred categories, the latter will be frequently utilized as well. To summarize, the aim of this essay is to explore the character of the financial analysts as it reveals itself through a dramatic background of the stock market. This will hopefully end up in a set of further issues that hopefully can be used as a basis for future investigations into the organization of the stock market from an actor-perspective.

The paper is outlined as follows. The subsequent part is a discussion of the analyst role as it could be interpreted according to financial theory. The theory will be read as a script that provides the role with personal characteristics and gives him<sup>2</sup> boundaries within which to hold. A common feature is that these playwrights seem to prefer to see the analyst as an objective bystander with a rather modest position compared to other actors. However, empirical observations reveal that analysts occasionally have problems to follow these stage directions. Relations to other actors seem to make the limits of the role troublesome. The rationale for using financial theory as a starting point is twofold. Firstly, as the domination of this genre on academic thinking on financial markets is long-established, it follows that this resource also is most likely to have revealed the dominating aspects of the financial analyst's character in relation to the market. Secondly, the connection between economic theory and practice can also be compared to the relation between the script and the act in a more literal sense. Economic theory can be regarded as a powerful agent that shapes the actors' conceptions and ideas about the workings of financial markets (Callon, 1998). In the

case of financial analysts, who are most likely to have some sort of academic background in economics, this idea has apparent implications.

The essays empirical component is based on a series of interviews with Swedish sell-side analysts. These interviews were enacted in the fall of 1999, when the market still believed in the magic powers of IT and herds of young Swedish entrepreneurs competed frenetically for investor support – which in itself provides a dramatic setting for the story. This material reveals how the actor himself might comprehend his role, his relations to other actors such as investors and managers, as well as to the script and the tools for valuation that it provides.

Based on the experiences made in the first two sections, the last part of the paper takes a radical turn and explores the character of the financial analyst via the jester's spirit. By making the analyst jester-like and the jester analyst-like, a fruitful cross-fertilization is brought forward. The jester/analyst is suggested as a figure that incorporates both the actor and his role. This in turn provides an outlook from which to illuminate the previously discovered aspects of the analyst's character.

## *The script*

Analysts gather information by following one or a few stocks, form opinions and write recommendations were stocks are appraised. Sell-side analysts are usually associated with broker/dealer firms that provide recommendations to profitable customers – generally large institutional investors. Literature on accounting and the capital market tend to give the analysts varying parts according to the plot of the research – placing him on different levels in the informational food chain. As a consumer of information, analyst decision-making is a natural source for studies of user-friendliness and relevance of accounting data (Vergossen, 1993), and experimental studies of how information is processed (Bouwman et al, 1987; Englund, 1999). This line of research assigns the analyst a rather modest role in relation to the market. As receivers of information input, analysts becomes qualified representatives of the investing public and somewhat detached from other market actors. Circumstances other than the one way supply of information that may influence and shape the analyst's work are put aside. Indeed, this makes a poor challenge to the analyst's acting abilities.

An opposite perspective pays attention to the informational output of the analyst's work. Here the most intriguing question concerns analysts' ability to make correct judgments about the followed stock. Several studies have tested the accuracy of analysts' future earnings estimates, as well as the quality of their stock recommendations. Brown et al. (1987) has shown that analysts' predictions of earnings at least outperform mechanical models. This observation makes analysts' forecasts popular proxies for market expectations in investigations in the stock price and earnings relation (Schipper, 1991; Abarbanell et al., 1995).<sup>3</sup> But, as earnings estimates only constitutes a step on the way to the analyst's final recommendation, a better test of the quality of the analysts' work is perhaps a direct test of the accuracy of the investment advice. Following this line of reasoning, Womack (1996), has shown that analysts' recommendations, particularly negative ones, have a significant impact on security prices. He states that analysts are able to either "*predict or influence stock prices*" (p. 138). This is peculiar, as the theory of market efficiency and the random movement of security prices condemns successful stock picking as a hopeless task. The contradictory nature of the huge energy and resources put down on equity research although this is supposed to be a theoretically impossible enterprise was recently pointed out by Barber et al, (2001). They use this paradox as a starting point for an investigation of whether analyst recommendations can be used to generate excess returns on the market. Their findings coincide with Womack's

a sensitive ear to analysts' recommendations may indeed be lucrative. However, the two studies do not seem to agree on how these results shall be interpreted in relation to market efficiency. Barber et al concludes that their results could be an indication of the inefficiency of the stock market on the semi-strong level. Womack, on the other hand, points to the extensive information costs involved in security analysis, if the information content of the recommendation itself is taken into account, the analyst's accuracy is merely a compensation for his time and effort, (Grossman & Stiglitz, 1980). In terms of the distinction made above, this could be interpreted as analysts are able to *influence* rather than *predict* stock prices as they provide the market with some sort of informational *value added* (it could for example consist of timeliness, or more "cultivated" information). This implies that analyst recommendations are put on an equal footing with information and disclosure that originates directly from the company (Healy & Palepu, 2001), and generates the following observation: "[r]esearch on the role of financial analysts in capital markets indicates that they play a valuable role in improving market efficiency" (p. 417). In sum, even if the theory of market efficiency is generated from a logic that makes the analyst superfluous, it still seems possible to make room for him in accordance with the very same theory.

What implications might this have for the analyst's role? The common link between the first two perspectives on the analyst's role is the underlying premise that causes the analyst to catch rational actor qualities. As such, the analyst's dealings with other actors are kept in the background, disconnected as he is from the market course of events. Still, as the output of the analyst work is valued on the same scale as other capital market information, the analyst's presence on the market scene is clearly recognized and accepted. But, the dual nature of the script, that both provides and denies the analyst legitimacy, complicates the role.

If the possible existence of market inefficiency is interpreted as a simultaneous threat and prerequisite for the continuous demand for financial analysis, the analyst himself has to be somewhat of an equilibrist. Neither actor, nor spectator: a silent messenger, a pure mechanism. I will call him the critic. However, this figure causes problems when his act escapes the restrictions of the role, and involves himself into relations with other actors. This has not gone unnoticed by financial theory.

Despite the accuracy of sell-recommendations, it seems that analysts avoid issuing them (Womack, 1996). Overall, analysts have a tendency towards optimistic forecasts (see for instance Easterwood & Nutt, 1999; Kothari, 2001), which has brought attention to the

institutional incentives they face. An obvious explanation for the analysts' positive tendency is the dependence on management for information. Negative recommendations threaten to influence management's well willingness and thus the access to relevant and timely information. Das et al. (1998) finds that optimistic bias in analysts forecasts are more frequent in companies where information asymmetry between management and investors is high, and consequently where analysts gain most from access to management for information. Other explanations are related to analysts working for brokerage/dealer firms, where trading commissions make up a great portion of the revenues. This could obviously tempt the analyst to skew his recommendations in order to promote the generation of trade, especially as the recommendation itself is free of charge for brokerage clients. Further, analysts follow companies that may very well also be clients of their employers corporate finance departments, which makes good relations valuable. It has been noted that buy recommendations issued by brokerage houses that has been involved in the underwriting of the stock, perform more poorly than buy recommendations from neutral brokerage houses (Lin & McNichols, 1998; Michaely & Womack, 1999). The observation that more research is done on firms with favorable future expectations makes McNichols & O'Brien (1998) conclude that these seems to be preferred to firms with poorer prospects. Brokerage houses can thus be alleged to face similar conflicts of interests as modern audit companies (Donaldson & Dunfee, 2002).

Auditor and analyst, professions that used to lead a quiet life behind the shelter of the invisible hand, has awakened a new interest of the investing public and caught the attention of market authorities. A couple of weeks ago, the attorney general of the state New York, Eliot Spitzer, filed a complaint against the investment firm Merrill Lynch. The analysts at their department for internet stock research were accused of recommending their clients to buy stock that internally were described as "piece of shit", "powder keg" or "bad smell".

*Since late 1999, the internet research analysts (the "internet group") at Merrill Lynch have published on a regular basis ratings for internet stocks that were misleading because: (1) the ratings in many cases did not reflect the analysts' true opinions of the companies; (2) as a matter of undisclosed, internal policy, no "reduce" or "sell" recommendations were issued, thereby converting a published five-point rating scale into a de facto three-point system; and (3) Merrill Lynch failed to disclose to the public that Merrill Lynch's ratings were tarnished by an undisclosed conflict of interest: the research analysts were acting as quasi-investment bankers for the companies at issue, often initiating, continuing, and/or manipulating research coverage for the purpose of attracting and keeping*

*investment banking clients, thereby producing misleading ratings that were neither objective nor independent, as they purported to be.*<sup>4</sup>

As the attentive reader might have noticed, the above complaint is a clear echo of the observations that were made by the previously mentioned scholars: analysts are too positive, they only follow companies with good expectations and they are too closely connected to their employers corporate finance departments. The analyst is put into question and accused of being neither objective, nor independent. The text is interesting as it articulates expectations on the analyst that are rarely expressed, just assumed, taken for granted. The public view of the analyst's role seems to be inspired by the silent critic that was introduced above. We will now turn to the analyst himself to see what he has to say about his deed.

## *The actor*

Despite their seemingly natural appearance at the stock market scene, the analytical profession is a fairly recent phenomenon. The Swedish Society of Financial Analysts (SFF) had 55 members registered when established in 1970 and 750 in 1995. At the turn of the century they had reached over 2000. The profession has a longer tradition in the US, but still, professional financial analysis appears to have been a rare phenomenon during the first half of the past century. This part of the paper is based upon an explorative interview study with sell-side analysts at Swedish banks and brokerage houses.<sup>5</sup> Sell-side, as opposed to buy-side, analysts are not associated with a particular investor; their recommendations are a service provided by their employer to the clients of the firm. While buy-side analysts typically follow a larger number of companies, sell-side analysts only do research on one or a few stocks within a narrow sector.

The initial purpose of the empirical research project was to find out how the respondents took intellectual capital and intangible resources into consideration when making their recommendations, and how these matters were linked to the overall value of the followed companies. Even if the conversations took varying turns, all interviews were kept within a semi-structured frame of four general topics. The analyst was asked to describe his own analytical procedure so that association could be made to the individual work situation. The information gathering process, systematization of data and general valuation methods was discussed as well as specific circumstances concerning the particular companies the analyst followed. This was used as a starting point for a dialogue around the factors that was considered most crucial to be able to carry out the analytic task and questions about the most appreciated sources of information. The final topic concerned difficulties and how the analyst thought the quality of his work could be improved or facilitated. These four topics were picked as a consequence of the initial purpose of the study. However, the open-ended questions gave the analysts opportunity to speak freely about matters that seemed of most concern. The interviews were conducted during a three-month period, which allowed time for experiences to be made and new thoughts to arise. Therefore, this material also provides a rich background to the respondents' own apprehension of their competence, their working conditions and hints the essence of the analyst's unique social role, without having explicitly posed questions about these matters. The logic behind this reasoning is uncomplicated: questions about what analysts do gives an account of what they are. The following is my

interpretation of these interviews regarding the matters that seem of most importance for the topic of this essay. Analysts' voices are heard between the paragraphs to support the arguments and to enliven the story.

When asked about their work, most analysts immediately mentioned one or several well-known quantitative valuation models, among which the most frequently described were discounted cash-flow models and tools for comparison such as price-earnings ratios. The preferred techniques are similar in character; small variations are either due to the line of business the analyst is following, or the brokerage house to which the analyst is associated. These models have a few well-defined inputs, which generally are taken from the companies financial reporting. The outcome is compared to the price of the company stock, which in turn provides an indication of whether the stock is over- or undervalued by the market. Despite the apparent importance of these models, and the fact that a lot of interview time was devoted to purely technical reasoning about financial data and measures, the analysts still expressed varying faith in these technologies. A common agreement was the lack of complete confidence in the method as a unique tool for performing the valuation. The sensitivity and trendy character of the valuation tools was frequently pointed out, particularly among the more experienced respondents whose professional careers were long enough to have outlived a few such methodologies. This provided an entry to a discussion about the meaning and use of these tools, both for the analyst himself in building up his argument and story as well as for the structure of the relations with clients and management of the followed company.

*I use different approaches according to situation and company it depends on varying fashions.*

*Discounted cash flows are sensitive to small changes, which makes it hard to handle the risk. I use them mostly because everybody else uses them; the model helps you build an argument...*

The symbolic significance of a quantitative argument when preparing for a risky decision might be of little surprise. However, it is important to point out that this not should be interpreted as the analyst is fooling the client, or do not himself actually believe in the essence of his argument. On the contrary, the respondents eagerly stressed the importance of honesty in front of the client. Nevertheless, to strike a balance between this symbolic facet of the model, and still make a convincing argument to takes a skilled rhetorician. The verbal skills of

the analysts are challenged both in his personal meetings with clients, and, as exemplified below, in the analyst's written report:

*Furthermore, we will introduce a new valuation model based on a sum-of-the-parts, which puts more focus on areas which build long-term value. The bank's retail, investment banking, asset management and life operations are valued separately in order to capture the differences in growth and capital needs, to reach a truer value of each of the operations.<sup>6</sup>*

The transitory character of the analysts' valuation model is also revealed in their impact on the final recommendation. A common reflection was that the models have lesser significance in bull markets when investors are less cautious, than in bear markets.

*That differs among different periods. Sometimes the model has lesser significance. An example is growth companies, like the IT-sector, where it is difficult to express the growth in numbers.*

The varying connection between the model and the recommendation has more to do with shifts in investor attitude than a varying validity of the models themselves. This highlights how the relation between the analyst and the investor directly shapes the analytical procedure.

The complicated valuation of IT-shares, which was a frequently discussed matter at the time of these conversations, gives a vivid illustration of the tension between the valuation model and the reality it purports to describe. As mentioned above, certain predetermined parameters within the companies are used as inputs in the models. These parameters were in many cases missing in the newly established IT-industry. Most companies didn't have enough of a history to build forecasts and estimations, and indeed lacked profit. This caused a lot of confusion even for experienced market actors.

*It is difficult to understand how companies within this line of business earn their money. The market is too immature and fundamentals don't seem to matter.*

The analyst can handle this dilemma by two perceivable strategies. He can either avoid recommending the share, due to lack of knowledge, or find a better way to build the argument. This is done by the search for new parameters that makes a more logic connection between the company and its market value.

*The analytical models that we use change much over time. Ratios become trendy for a while and then disappear. In the 80's the balance sheet and the value of material assets was important, then the P/E-ratio arrived... the main thing is that everyone uses the same model. One example is the IT-sector. There you can't use P/E-ratios as the companies frequently run at a loss. Therefore we started to use price/sales ratios instead, inspired by an American model. The problem was that these ratios rose so fast that they lost in predictability. Now we have started to use market value per employee instead. This change has influenced the companies' market values. Before the numbers indicated an obvious sell! The new ratio unexpectedly justified buys! When it was initiated, the number of employees was suddenly momentous for market value. When we started to compare with American companies one could suddenly see that wow, these companies may actually be valued at a low price. The recommendation turned into buy. When a respected brokerage house starts using the new ratio it becomes in some way accepted, legitimate.*

The valuation models described by the analysts are derived from a logic that is more or less directly adopted from financial theory. They provide a good example of how economics shape the economy, or to use the adopted framework, how the script influences the analysts role. As such, the model defines a few concrete durable inputs, frame the investment object<sup>7</sup> and thereby help the building of the recommendation. However, the way of relating to these methods, their trend dependency and the way that they are used indicates that valuation models can be regarded as powerful agents in themselves with intimate relations to a most tangible social context. In dramatist terms, the script becomes part of the scenery that provides the actors with a common ground that facilitates discussions around the valuation with other actors. This stabilizing ability has a soothing effect on the otherwise hopelessly transitory character of the investment object. But sudden shifts in the balance between the script/scenery and the market course of events threatens the peace. The before so stable scenery falls apart and allows the analyst to improvise and play around with the script just as he pleases. So, the acting abilities of the financial analyst are revealed under a surface of technical models and massive statistics. But the dramatic qualities of financial analysis also have a more apparent side. Above all, this is exposed in the qualitative assessment of the company that accompanies the quantitative valuation models. For reasons mentioned above, qualitative data are described as problematic.

*Soft variables are difficult to quantify, which makes them hard to motivate in front of investors.*

Qualitative parameters typically enter the model via the back entrance of the yield requirement, which above all is estimated on the basis of company specific risk. Here, the trustworthiness of management is essential.

*To estimate the yield requirement, management credibility is crucial. The more open management is, the lower their cost of capital, it has to do with the amount of certainty with which you can make the forecast.*

*The credibility of management defines the borders within which the market can believe in the company.*

The yield requirement makes the subjective conception of risk manageable by translating it into a quantitative measure. However, it was difficult for the respondents to express specifically how credibility was estimated and how the translation from trust into risk was executed. But management's ability to articulate their view of the company verbally was continuously associated with notions such as credibility and trustworthiness.

*It's important that management can express what they want to do with their company. To attract buyers they have to be able to sell their strategy and vision in the right manner... tell a good story!*

Analysts talk willingly about certain executives' ability to tell a story and reach out to the market.

*I ask myself: Can they sell their message? Is management on the right track? Do they seem able to catch investor-attention? It's important to consider management's relation to the capital market. If they can't convey a message to investors, they can't do it to customers or anyone else.*

The meaning of a good story is naturally difficult to express. But a common answer was of course that this evaluation of management always was related to past performance, particularly according to the track record of kept promises. Other mentioned indicators were humility, consistency and personal character. To assess these characteristics, contacts with management, (typically represented by investor relations, financial officer or managing director), was consequently the most crucial input. Over all, the importance of communications with management was emphasized when talking about sources of information. Many analysts described it as the most essential, which coincides with previous observations, (see for instance Previts & Bricker, 1994).

*Private communication with the company's investor relations' manager, CEO or division managers is always the most valuable source of information. The more open, the better. This gives earnings visibility and reduces risk.*

*The quality of the communication to the market signifies how the rest of business is managed.*

Important platforms of such verbal communication are occasions such as analyst calls and company hearings. These events can be characterized as semi-public, as only analysts and representatives from the media are invited. In the US this restriction of attendants has caught the attention of the SEC. The so-called Regulation Full Disclosure has of October 2001, prohibited the inclusion of some attendants at the expense of others – everything that may be classified as information must be communicated publicly at once. Even if the Swedish version of these get-togethers is not as strictly regulated, nothing can officially be said that is not immediately communicated to the whole market. Still, analysts keep recurring to the importance of company-hearings. It is important to note that these meetings are not only a one-sided communication. By the regular attendance, the analysts get to know management, understand how to interpret their messages and learn how to pose the right questions. By the opportunity to interrogate, the analyst gets feedback on his view on the future. Judgements that otherwise are done in solitude can be discussed. This two-way communication also makes it possible to read signals and messages that are not explicitly expressed. For example, a simple matter as what slips the discussion can convey important information. One analyst tells me about meetings with representatives of a forestry company:

*In good times, when the order book is sufficiently large, it is spontaneously reported on the analyst meetings. However, if ordering is slowing down, this is not mentioned at all, and the company answers vaguely on questions about future ordering. This is ridiculous as such answers give you enough information anyway. If they don't say anything, you know that times are bad!*

It was also indicated that these are important social occasions and great chances to make acquaintances both with company representatives and other analysts following the same line of business. Regular meetings like these are therefore a breeding ground for future informal contacts.<sup>8</sup> Respondents with long professional experience pointed to the advantage of a large network of associations within the followed companies, ties that make a difference in comparison with other analysts. These informal discussions form a grey zone that loosens the border between public and non-public information and awakens the fear of insider affairs (Johansson, 2001). However, these analysts emphasized eagerly that this did not involve the

access to inside information, which is a delicate matter. Caution about doubtful information is specifically important for keeping healthy relations with large institutional investors, whose investments are subjected to regular scrutiny. Personal meetings with company representatives are opportunities to get feedback on estimates and to check and discuss assumptions about the future. In this way, the analytical process can be described as a circular, where estimations are tuned with the help of management.

The analyst's dependency on management connections is not one-sided. On the contrary, close relations can be claimed to be of mutual interest. The company benefits from less fluctuation in the market value of their stock, which in turn makes good relations to market actors useful. Intense analyst following is also a constant reminder of investor presence and puts management under close scrutiny. As a communicative link between management and investors, the analyst reduces information asymmetry and thus, the argument goes, agency costs of debt and equity. Therefore it can be asserted that the analyst, just like the auditor, plays a part as a monitor of managerial performance (Jensen & Meckling, 1976; Moyer et al 1989). As such, the analysts generate the necessary faith for investors to be willing to entrust management with their capital. In this view, financial analysis can be likened to auditing and other trust-generating institutions that are essential for the exchange mechanism to function on modern capital markets (Neu, 1991). However, this requires the analytical profession to maintain continuous legitimacy. Massive information gathering, statistical valuation models and academic background has a symbolic significance that supports myths of rationality.

*There is a formal structure within the organisation how this work should be carried out. This serves only as an outline, but it emphasizes the technical aspects of the argumentation.*

Rogers and Fogarty (1997) has pointed out that this social part played by analysts is decoupled from the task they perform, and shows how this is done verbally in written analyst reports. Curiously, many analysts described the written report of secondary importance in comparison to personal contacts with investors. An analyst of forest industry describes the morning meetings between analyst and investor that are continuously arranged:

*The client's interest has to be caught immediately. The first minutes, when you just stepped into the room, are the most crucial. You can tell almost immediately whether the client is interested or not.*

This quote will be the last thing we here of the analysts in this section of the essay. But before I end, I will make a few comments on what to bring into the finale. There is an obvious technical side to securities research. Analysts spare no effort in the search for fine tuned valuation tools and solid financial statistics. The formal structure of the analyst's work has symbolic significance that marks the rationality on which analytical authority is built. It serves to keep up the arguments in front of clients and, in a wider perspective, can even be asserted to generate trust for the market institution as a whole. However, even if the legitimacy of these models is anchored in financial theory, the analyst way of describing their relation to them reveals that they can be better understood as scenery, or even props that can be changed along with the market course of events.

In the growing cracks of the formal aspects of the analyst's role, a more social character is exposed. Numbers have to be filled with meaning to be utilized in the recommendation. Close relations with company representatives as well as other analysts become crucial to ease the ambiguity of the market. Finally, when the analyst stands before his client, he has left the last feature of the critic behind and is now center stage.

## *The jester*

*It's a well-known saying  
That no play, no matter how short,  
Must be without its fool*

Martyr Christianus, 16th century

At a first glance, the historical character of the fool or the court jester has little in common with the analysts' rather contemporary appearance. For instance, the most striking characteristic of the jester is his humour, but is a financial analyst funny? Perhaps. This is not, however, the central argument of this essay. As we will see, the jester's spirit is far more complex than the ordinary entertainers. This makes him attractive as a dramatic figure of thought that both facilitates, and hopefully also deepens, the understanding of the rather contradictory features of the analyst's character.

In the medieval drama, the jester's lines were not always included in the script. He was allowed to enter the scene whenever he felt like it, improvising his role and mocking the other characters if they weren't enough convincing. His part could have such an impact on the outcome of the act, that the audience could never be sure that the play they witnessed was the same as that performed the previous night. This raises the question if the jester should be regarded as the actor's or the playwright's creation?

*In drama the court jester or clown was often a bridge between the characters in the play and the audience. He belonged to the play and often had a central role in it, but he was also detached, and his asides could make it seem he was more aware of the presence of an audience than any of the other characters. This is exactly what court jesters did in real life – they could be at the nub of the action and then suddenly stand outside it with their dispassionate observations. (Otto, 2001, p. 230)*

The access to both the scene and the audience can be detected in the script of financial theory in terms of the analyst's double role as an information consumer and producer. But this ability of presence and absence has further implications. On an institutional level, Rogers and Fogarty (1997) describes this in terms of a de-coupled relation between the formal structure of the analysts work – his role – and the analyst as a social actor. This blurred boundary between the actor and the role was also exposed by financial theory and analysts were accused of

lacking in objectivity and being dependent on their institutional environment. Does the jester's character imply that the analyst is a cheat, a crook or even a swindler? "*There is no slander in an allowed fool, though he do nothing but rail*", says Olivia in Twelfth Night. Actually, one of the jester's most important functions was to reveal the truth. Under the safe guise of folly, he would get away with expressing uncomfortable aspects of reality in a social context that was infected with political considerations and unevenly distributed power.

"*Anyone who doesn't wish to see a fool should smash his mirror*" was the motto of the medieval French fool society *Infanterie Dijonnaise*. (Otto, 2001, p. 98). This maxim reflects the perception of the mirror as a discloser of the truth, a quality shared with jesters. Indeed, the mirror was so metaphorically linked to the jester's character as it even popped up in the names of some celebrated medieval Chinese jesters: *Newly Polished Mirror*, *Mirrorlike Lu* and *Adding Clarity* – the last one being a spin off on the same theme. In Shakespeare's comedy, *As You Like It*, a central character is *Touchstone*, the fool, whose name points to the one who can distinguish pure gold from mere alloys and test or try the genuineness of anything. Another facet of the mirror is the possibility to turn the world on its head, viewing reality reversed and upside down. The inversion of the analyst, that masks himself behind technical models and quantitative measures, is the jester that uses his wit and foolishness as a license to speak freely and reveal his perspective on the world. Free access to such truths and stories are convenient, as they can be utilized as covers for other people's opinions, using the jester as scapegoat if anything should go wrong. To keep a balance between symbolic measures and convincing arguments – foolishness and clever truths – is a delicate endeavour that takes a skilled rhetorician. The ability to present a different angle or interpretation of reality makes the poet and the jester kindred spirits.<sup>9</sup> The earliest ancestors of the medieval and renaissance jesters were comic mime actors that were a popular ingredient in dramatic performances in ancient Greece and Rome (Otto, 2001). Their name was not used in the modern sense, referring to a wordless art. The term *mime* has its roots in *mimesis*, the representation of reality in drama and literature, and the mimes were considered to be verbal masters. The analyst's poetic skills are continuously challenged in both the oral and written recommendation.

The ability to speak the truth gave the jester a unique position in courts and similar prominent environments. One of the most famous renaissance court jesters was *Will Summers*, the fool of *Henry VIII* of England. The closeness between *Henry VIII* and his jester *Will Somers* is

renowned; Will had free access to his master's presence and was always welcomed (Billington, 1984). What is the secret behind this intimacy between the power and its commentator?

*Every organism, whether individual, corporate, natural or political, needs to be challenged and renewed continually in order to survive, and artists, in their portrayals of this process or its failure, have frequently assigned the role of harbinger of the process to a court fool figure of some sort. (Otto, 2001, p. 48)*

The jester's unique and intimate relation to an authority singles him out in the multitude of clowns, comedians and buffoons. Analysts' voices were raised to praise close social relations between analyst's and company officials, which were considered vital for the ability to carry out the analytical task. But as any relation, the dependency is not one sided. As a vital and unofficial link between the monarch and his people, the jester grants indirect access to the throne for subjects without necessary contacts, and gives voice to the words of the king in front of ordinary citizens. Undeniably, a reoccurring theme in both medieval drama and the life of real-world jesters was the inverted servant master relationship (Otto, 2001). As an unofficial version of the auditor, the analyst has the ability to put management under scrutiny, but his rare symbolic presence also facilitates the creation of investor confidence (Moyer et al, 1989). But this likeness was also part of the cause to the accusations of the analyst being too closely attached to the investment banking interests of his employer firm. The license of the jester to speak truthfully is connected to his folly. But when someone dresses up in his cloak, he is often granted the same privilege. The counterfeit fool was considered such a problem in 15<sup>th</sup> century Scotland that an Act of Away-Putting of Feynet Fools was passed in January 1449, meting out punishments as ear nailing and amputation for anyone who tried to fake the jesters character (Otto, 2001). The opposition in both being a fool and a prophet could thus lead to painful consequences. However, this institutionalized ambiguity is at the same the key to the secret of the jester, and clarifies the analyst's unique relation to the stock market drama. While on the one hand generating confidence in the workings of the market, he also creates the necessary uncertainty for the audience to question his act. Is he playing according to the script? Is he improvising or not? By mocking his theoretical boundaries the jester is able to balance on the thin line between trust and risk out of where stock market action is born.

*"...juggler, confidant, scapegoat, prophet and counsellor all in one." (Otto, 2001, p. 6)*

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<sup>1</sup> Burke (1969) uses six such categories in his famous dramatist model: agent, purpose, scene, agency and act. Only three of them are used here: agent (actor), scene and act. Another one is also mentioned, the audience, which seems to be an unavoidable category when discussing the stock market.

<sup>2</sup> In this essay, the analysts are referred to as male; although I am aware of that security analysis very well can be carried out by women. The use of male gender is due to the fact that only one of the 26 respondents was female. In addition, the traditional jester is typically a man.

<sup>3</sup> Beating a model based on historical data might however not be too demanding, as Katherine Schipper puts it: “...a surprising degree of incompetence or an exotically perverse objective function would be required for analysts to lack the capability to equal or exceed the predictive accuracy of models based only on past earnings most or all of the time” (1991, p. 119).

<sup>4</sup> Inquiry by Eliot Spitzer, Attorney General of the State of New York, Supreme Court of the state of New York, county of New York.

<sup>5</sup> In sum, 26 interviews were completed, that took around one hour each. The analysts were associated with eight different brokerage houses and were picked from the following sectors: telecom and IT-industry, steel and forestry, biotech, banking, trading companies and motor industry. The selection was made so that the respondents should be reasonably even distributed in regard to employer and sector.

<sup>6</sup> Alfred Berg equity research, *Company Report Föreningsparbanken*, July 1999.

<sup>7</sup> Hägglund (2001) employs the term ‘investment object’, which signifies the company in the perspective of investors. This is useful as the term ‘the company’ denotes varying aspects that could be misleading for the present context.

<sup>8</sup> In the US, these meetings have brought the attention of the SEC. As of October 2001, the so-called Regulation Full Disclosure has prohibited the restriction of the number of attendants. Information has to be communicated publicly at once.

<sup>9</sup> In Dutch, the term *redrijkersnar* meant reasoning fool, or fool rhetorician. In Ireland, where the poet holds a special position, the poet’s and the jester’s characters were often mixed. It was believed that the words of the poet/jester “could cause almost physical harm, almost like a magic spell”. (Otto, 2001, p. 14)