Internet Appendix for: Do Financial Analysis Restrain Insiders' Informational Advantage?

This appendix reports additional information on the trading activity of institutional investors and insiders for the sample of 847 firms that suffered coverage termination and the control group.

A. Institutional Investors and Firm Insiders

The behavior of institutional investors around coverage termination is important for two reasons. First, institutional investors may leave before coverage termination, in which case institutional selling may be another explanation for coverage termination. If analysts are (indirectly) compensated through commissions generated by volume, then lower institutional presence should translate into lower volume, lower commissions, and lower profits from providing information. Second, if institutional investors leave after coverage termination then insiders' informational advantage may further increase, because insiders will face no competition from potentially informed institutional investors.[1] To investigate this behavior around coverage termination we compile data on institutional holdings and changes in holdings of the sample and control firms. We present our results in Figure A1.

[1] The issue of potential simultaneity between institutional trading and coverage termination was investigated by O'Brien and Bhushan (1990), who find no clear evidence on the simultaneity between the number of analysts following stocks and institutional holdings. The authors find clear evidence that institutional holdings in a specific year are positively influenced by the number of analysts following a stock in the previous year. In addition, they show that the impact of previous-year institutional holdings on analysts following is insignificant.

FIGURE A.1

Quarterly Average Institutional Holdings

Figure A.1 shows quarterly average institutional holdings as a percentage of shares outstanding for our sample composed of 847 firms that suffered coverage termination and the control group that continued to be covered by analysts. The quarterly time series span over a window of two years before to two years after coverage termination (quarter -7 to quarter +8).

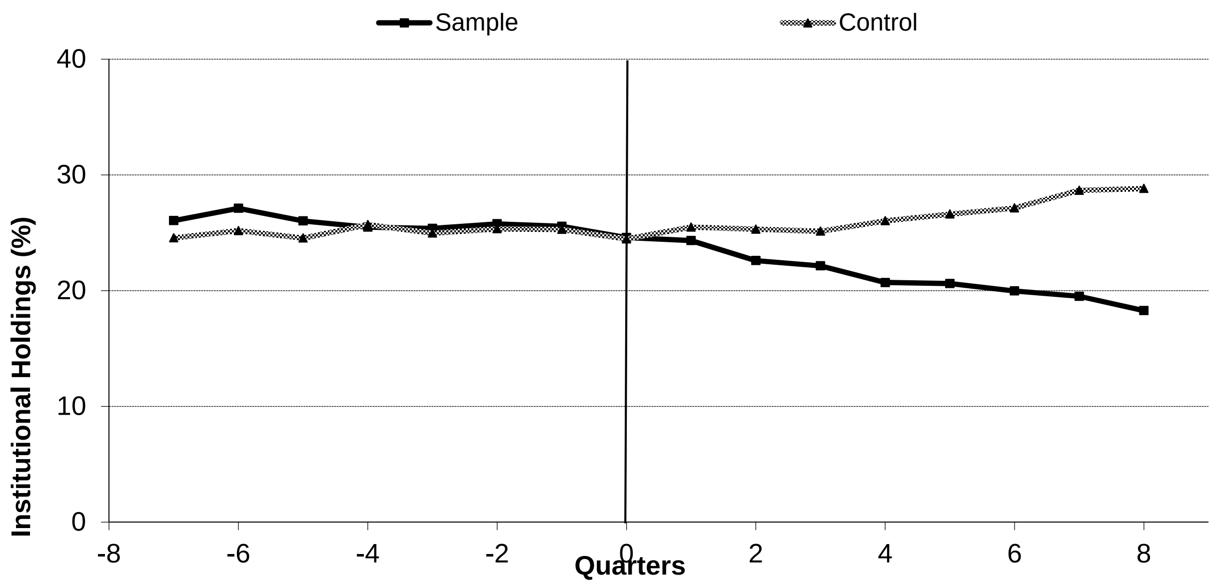

Figure A1 shows quarterly average percentage institutional holdings for firms in our sample and their controls for two years before and after coverage termination. The figure clearly shows that institutional investors do not leave our sample stocks before coverage termination. Institutions hold around 25% for both sample and control firms up to quarter -1. Starting from quarter +1 there is a significant decrease in their holdings and the decline continues until quarter +8. There is no such decrease in the institutional holdings of control firms.

The results in Figure A1 indicate that institutional shareholders do not leave before analysts, and hence, they cannot be the cause of coverage termination. Institutional shareholders sell their shareholdings *after* coverage termination and selling goes on over a protracted period. Applying the methodology of O'Brien and Bhushan (1990), where previous year's institutional holdings is a determinant of analyst following, we can investigate the change of institutional holdings from quarter -7 to quarter -4 and the impact on coverage termination. Institutional holdings over these four quarters decrease marginally (from 26.05% to 25.49%). The change is not statistically different from zero and it is too small to explain the decision of analysts to terminate coverage.

How do insiders react to coverage termination? We investigate this issue by looking at both insider holdings and insiders' volume using the Thomson Financial Filling Data Files. Quarterly figures of insider holdings as a percentage of shares outstanding and insider trading volume as a percentage of total shares traded are presented in Figures A2 and A3.

FIGURE A.2

Quarterly Average Insider Holdings

Figure A.2 shows quarterly average insider holdings as a percentage of shares outstanding for our sample composed of 847 firms that suffered coverage termination and the control group of firms that continued to be covered by analysts. The quarterly time series span over a window of two years before to two years after coverage termination (quarter -7 to quarter +8).

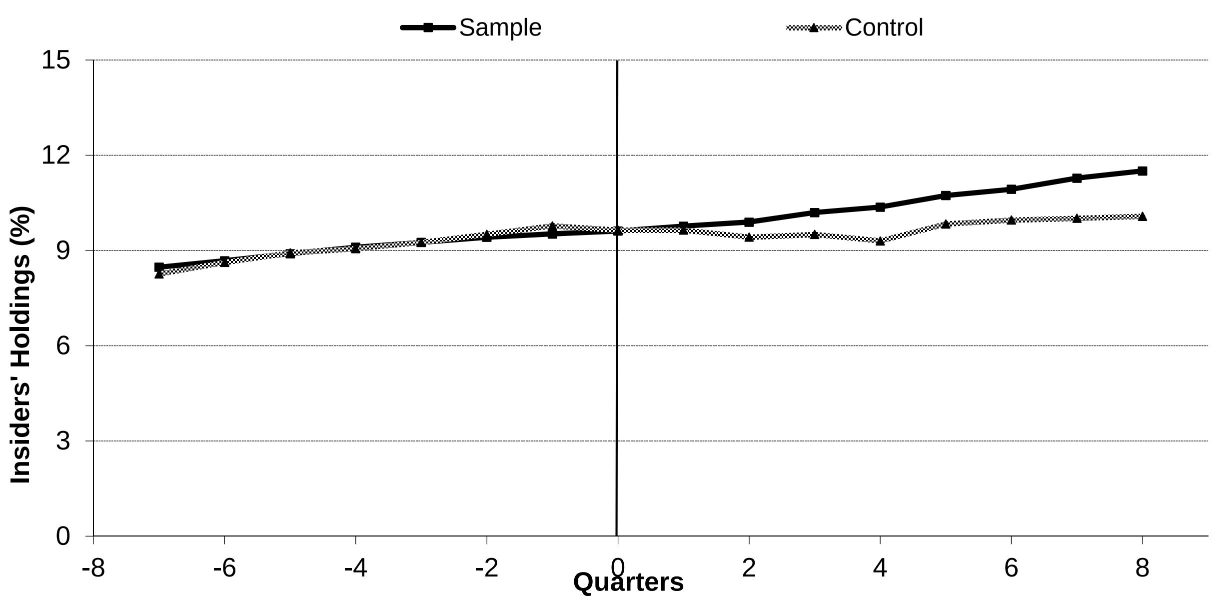

FIGURE A.3

Quarterly Average Insider Share Volume

Figure A.3 shows quarterly average insider share volume as a percentage of total share volume traded for our sample composed of 847 firms that suffered coverage termination and the control group of firms that continued to be covered by analysts. The quarterly time series span over a window of two years before to two years after coverage termination (quarter -7 to quarter +8).

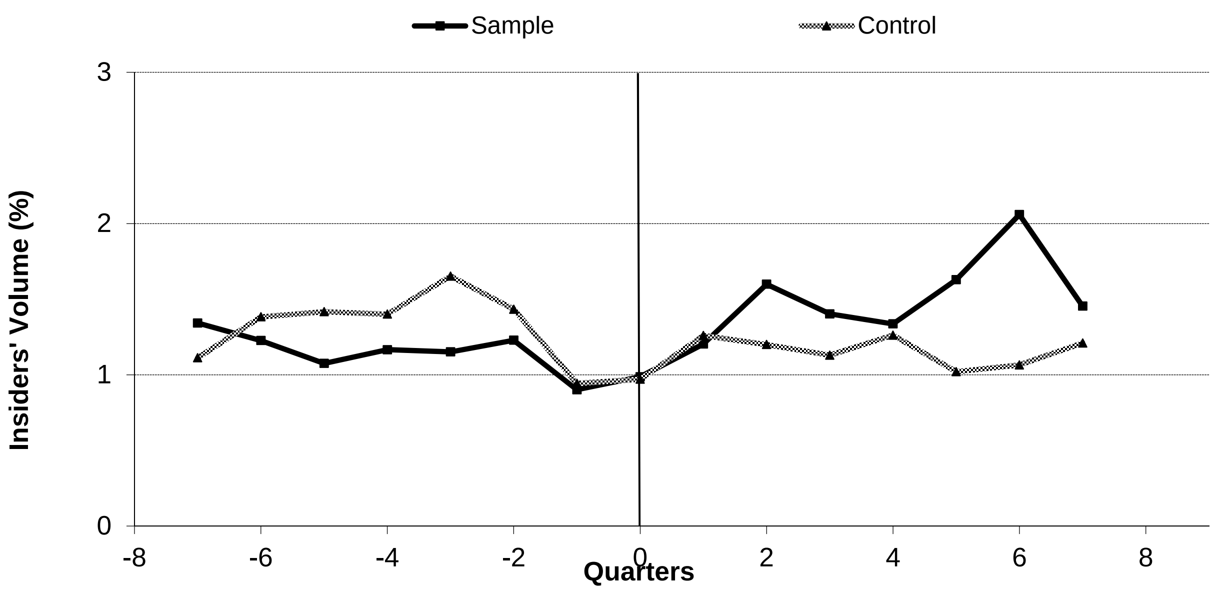

Figure A2 shows that in the two years preceding coverage termination insiders in control firms have very similar mean holdings relative to the sample stocks. There are no differences between insider holdings of sample and control firms until quarter +1; significant changes occur starting from quarter +2 and continue in the two years following coverage termination. Insider average holdings increase from 8.5% in quarter -7 to around 11.5% in quarter +5. This evidence shows that insiders in firms losing coverage react differently than institutional investors, who instead sell a significant part of their holdings. Figure A3 shows average insiders' quarterly trading volume as a percentage of shares traded for the sample and control firms. The presence of insiders in the trading process increases significantly after coverage termination only for the sample stocks.

References

O'Brien, P. C. and R. Bhushan, 1990, Analyst Following and Institutional Ownership, *Journal of Accounting Research* 28, 55–76.