

## Inside the “Black Box” of Sell-Side Financial Analysts

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### ABSTRACT

Our objective is to penetrate the “black box” of sell-side financial analysts by providing new insights into the inputs analysts use and the incentives they face. We survey 365 analysts and conduct 18 follow-up interviews covering a wide range of topics, including the inputs to analysts’ earnings forecasts and stock recommendations, the value of their industry knowledge, the determinants of their compensation, the career benefits of *Institutional Investor All-Star* status, and the factors they consider indicative of high-quality earnings. One important finding is that *private* communication with management is a more useful input to analysts’ earnings forecasts and stock recommendations than their own primary research, recent earnings performance, and recent 10-K and 10-Q reports. Another notable finding is that issuing earnings forecasts and stock recommendations that are well below the consensus often leads to an *increase* in analysts’ credibility with their investing clients. We conduct cross-sectional analyses that highlight the impact of analyst and brokerage characteristics on analysts’ inputs and incentives. Our findings are relevant to investors, managers, analysts, and academic researchers.

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