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*Guiding the herd and what household energy consumption tells us about managing consensus*

Managing consensus is a primary responsibility of IROs and, although not immediately apparent, is at risk from the same social biases that drive herd behaviour and result in investment bubbles. A complex interaction between companies, regulators, analysts and investors has generated a debate around how companies should manage consensus. This briefing applies the theories developed in the field of behavioural finance to illuminate the debate and makes a number of recommendations for communicating consensus.

Companies will have their own forecasts for internal purposes to set the direction of their business, but they do not usually publish them. Regulations constrain quoted companies from explicitly setting out their own forecasts, and the role of setting market expectations is performed by equity analysts. Companies are, however, judged by their ability to meet the consensus of analysts' forecasts and must notify the market if they believe performance will diverge materially from consensus. In most cases, a company will provide analysts with a certain amount of guidance to avoid having to issue a profits warning or upgrade statement.

The forecast is entirely down to the analyst's discretion and could vary markedly from the company's own expectations of performance. Some analysts prefer to ignore financial guidance issued by the company believing it has an overoptimistic or deliberately cautious view or is too slow to adjust its forecast to reflect a change in the economy or marketplace. An analyst that makes a successful call can make their career if it turned out to be correct when everybody else was wrong.

In most cases, analysts tend to follow the consensus, which reflects a tendency by people to change their actions to be more in line with the norm. A study in the US measured weekly energy consumption for 300 households and gave feedback to homeowners about how their consumption compared to the neighbourhood average. During the experiment, those who had been consuming more energy than their neighbours reduced their energy consumption. More surprisingly, households that had been consuming less energy than their neighbours actually increased their consumption. The study showed that people change their actions to be more in line with the norm regardless of whether they were previously behaving in a socially desirable or undesirable way.

The findings are consistent with social bias identified by behavioural finance, which accepts that people have a desire to be accepted by a group and look for safety in numbers with the rationale that such a large group cannot be wrong. Moreover, if the group is wrong, an individual can justify their decision by pointing out how many other people were led astray. This will be familiar to IROs monitoring analysts' forecasts for their company, which tend to hover around the average. Most analysts prefer not to go out on a limb and inaccurate earnings forecasts are not likely to be career threatening if their peers also got it wrong. Some companies might argue that it is desirable for analysts to be drawn to the average as it suggests the earnings outlook is well understood, but there are risks. If momentum gathers around overoptimistic forecasts, which is not checked, it can contribute to the creation of an investment bubble and subsequently damage a company's credibility.

The psychology driving human behaviour is virtually impossible to change, but by recognising it and making some changes to our communication we can try and prevent the worst outcomes. Countering social biases is helped by depersonalising the processes of managing consensus and making it as transparent as possible. For example, IROs should intervene to ensure that specific items such as goodwill and pension interest are treated consistently so that analysts can focus on the underlying drivers of the share price. We also advocate companies publishing consensus on their website with disclaimers to stress impartiality. Having established a track record in this area and managed the process for a number of clients, we have seen its benefits as long as the numbers are based on timely data collected directly from analysts and drawn up on a consistent basis. While it could be argued that it draws analysts towards the median, we argue that this is difficult to avoid and that the transparency

of consistent and timely consensus is preferable to a range of non-comparable estimates. Companies are sometimes nervous of publishing consensus for fear of it being perceived as an official endorsement, but this misses the wider argument and bigger risks inherent in consensus management.

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