Does Cross-listing Influence Chinese Firm’s Earnings Management and Analyst Forecast Accuracy?

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I. Introduction

This paper empirically examines the effect of cross-listing on earning management and analyst forecast accuracy for Chinese firms during the period of 2003 and 2006. We examine two hypotheses that the opportunistic earnings management of cross-listed firms should be less frequent and that the accuracy of analysts’ forecasts of the accounting information of cross-listed firms should be greater. This is based on the premise that the quality of accounting information of cross-listed firms is both different and better. The strength of the capital markets depends on investors’ confidence, and in turn, investors rely on credible corporate financial information to make investment decisions. The effective monitoring of the credibility of financial reporting is fundamental to the vibrancy of the capital markets. When firms’ cross-list on a developed market, the disclosure behavior of firms attracts more scrutiny and thereby yields a significant increase in the quantity and quality of firms’ disclosure (Coffee, 1999). Thus, compared with their non-cross-listed counterparts, we expect cross-listed Chinese firms to have lower information asymmetry, produce better earnings quality, smaller in earnings management and greater forecast accuracy. As efforts increase to improve the consistency and harmony of accounting principles and practices between

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countries, following the globalization of business activities (Pownall and Schipper 1999), attention has been recently drawn towards issues related to businesses’ accounting and public notices following cross-listing between countries.

More and more people, including investors, researchers and officials, are interested in China’s stock market and in Chinese listed firms. Chinese firms can be grouped into the following types: first, those listed only in the Chinese domestic stock market; second, those listed only on foreign markets—many Chinese venture companies selected to public in foreign stock markets, mainly on NASDAQ (National Association of Securities Dealers Automated Quotations)†; third, those not only listed on Chinese domestic stock markets, but also listed in foreign markets at the same time.

The improvement of the information environment and its impact on capital market is thus of a great interest to these investors. In addition, the trend in cross-listing continues to increase, as various countries encourage more companies to seek opportunities to obtain foreign capital. The Chinese Securities Regulatory Commission has simplified the approval process to make it easier for firms to cross-list on foreign stock exchanges (Reuters News, 2003). Thus, our investigation into the economic consequences of cross-listing will have implications for firms seeking cross-listing, as well as the policy-makers from emerging markets.

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† In China, those small venture companies are listed on NASDAQ, due to lack of adequate capital market for these industries.