DOCTORAL THESIS

Two Essays on Value of Analysts' Recommendations in China

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ABSTRACT

The role of analysts is important for investors. On the one hand, analysts serve as the information intermediary between firms and investors. Their recommendations improve the informativeness of stock prices. On the other hand, investors may formulate their investment strategy based on analysts' recommendations.

This thesis examines the value of analysts' recommendations in China by two essays. We choose Chinese stock markets, instead of developed stock markets for three reasons: First, analysts' industry is growing rapidly in China since 2004 and investors rely heavily on analysts' recommendation to make investment. With high percentage of retail investors in China, it is worthwhile to examine whether the analysts' recommendations impose investment value to investors or not over time. Second, unlike developed stock markets, the percentage of state-owned enterprise and the shareholding concentration is higher in China. The value of analysts' recommendation may vary under different natures in ownership structures. Third, to improve the efficiency of stock markets, Chinese government has implemented different regulations in the markets. For example, on 1st April 2010, it allows short sale in the stock markets. But it imposes strict short sale control after August 2016. It provides a unique setting to test the value of analysts' recommendations with changes in regulation.

The first essay uses event study method to analyze the value of analyst recommendation revisions in the Chinese stock market with different degrees of short sale restrictions. We find that downgraded revisions have significantly smaller effects on the stock prices of short sale–eligible stocks than they do when the short sale restrictions are stricter, especially for the large size stocks. This result is consistent with the overpricing hypothesis presented by Miller (1977), who argued that short sale constraints cause stock price overvaluation. We also discover that the value of downgraded revisions is nonsignificant when short sale is banned. However, after considering the influential recommendation revision, the abnormal return from downgrade revision becomes smaller for short sale eligible stocks compared to ineligible stocks.

The second essay examines the effects of security analysts' recommendation revisions, including initiations, upgrade revisions, and downgrade revisions, on stock price synchronicity under different ownership structures in China. Using data from 2005 to 2020, we find that upgrade revisions include firm-specific information while initiations and downgrade revisions provide information that is either market-wide or insignificant to investors. Furthermore, when ownership is private, the negative effect of upgrade revisions on stock price synchronicity is enhanced. In contrast to the US stock market, we also find that the informativeness of analysts' recommendation revisions in China vanishes during crises. Our results suggest that the reform of state-owned firms to private ownership may reduce obstacles to information distribution and increase market efficiency through security analyst channels.