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Guest Editorial

The Chinese Financial System and China's Role in the Financial World

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Since the re-opening of the Chinese stock markets in late 1990, it has since developed into a vibrant market with more than twelve trillion USD total market capitalization in 2020, second only to the U.S. Despite the rapid development in the market size, however, information transparency, the rule of laws, market regulations, market efficiency, and institutional discipline remain to be less desirable. To be sure, market frictions also provide researchers ample opportunities to discover the behaviour of market participants, and the findings serve as a mirror for other emerging markets. With that in mind, in this special issue we have collected five papers that study the effect of media on the market expectations, earnings manipulation in a corporate acquisition event, insider's trading in the fraudulent stock repurchase program, market inefficiency that results in significant arbitrage profit in the Treasury futures markets, and the relation between investor's inattention and corporate earnings announcement effect.

Zhang and *Du* (2022) investigate whether China's state-controlled media played a role in stabilizing investors' expectations by examining the relations between media tone and Chinese stock market reactions in the context of China-US trade frictions. The authors find that firms heavily exposed to export business with the U.S. produced significant positive reactions to a high media tone of the state media. Investors, especially SME investors, perceived more uncertainties to the high tones of Chinese media in the early days of Trump's presidency and reacted negatively to the media's high stance. After the war was waged, higher-tone news released from the state-controlled press eased people's anxieties and stabilized the market, especially for the large caps, leading to lower volatilities in most subsequent stages. The authors conclude that the official media's tone manipulation is partially effective in preventing a market meltdown and easing investors' worries.

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Mughal, Haque, Zahid, Ali, and *Li* (2022) examine earnings management in target firms before the acquisition announcement and the impact on shareholders' wealth. Using a sample of 3,455 Chinese listed firms that are targets of successful acquisitions over the period 2007–2020, and for a matched sample of non-targets, the authors find that target firms manipulate earnings in quarters leading to the announcement date, and evidence of a negative relationship between earnings management and short-term gains to shareholders. The result remains robust after controlling for various deal characteristics. The results also suggest that pre-merger earnings management in target firms is not fully anticipated by the market before the takeover announcement. However, there is no evidence of earnings management immediately after the announcement quarter.

Wang, Li, Tang, and *Sun* (2022) study the insider trading behaviour related to the firm's stock repurchase announcement in China. Since share repurchase conveys information to investors, when a company announces share buyback, the company's stock price will generally rise immediately. The authors find that some insiders create a fake repurchase event and terminate the plan early without buying the shares back. When the stock price rises due to the announcement, the insiders sell their shares at a higher price. This paper studies the short-term reactions around the repurchase event, including fraudulent share repurchase, using a sample of 2,272 repurchase firms in the Chinese stock market from 2013 to 2019. The authors find that insider trading around the repurchase event is prevalent and insider trading of fraudulent repurchase is most serious. More interestingly, the authors find that companies with more serious agency problem and poorer corporate governance are more likely to engage in fraudulent repurchase, and that companies with lower EPS and ROA, higher firm size and higher leverage are more prone to have fraudulent repurchase event. This paper thus provides practical guidance in differentiating the normal repurchase from the fraudulent repurchase.

Wang, Zhong and *Yu* (2022) examine the market efficiency of inter-variety of Treasury futures (ten-, five-, and two-year) in China's futures market by analysing their deviation and the equilibrium reversion speed. The authors build arbitrage-free spread intervals using auto-regression model to fit and predict the spot yield, CTD (cheapest to deliver) price to value Treasury futures and incorporate the transaction cost and market friction. The authors find that there are many arbitrage opportunities among the three varieties of Treasury futures, and the market is not fully efficient. Further analysis of the pairwise spread relationship of the futures show that longer operation of the Treasury futures market leads to higher market efficiency, shorter duration of arbitrage opportunities, and a faster revert to equilibrium.

Finally, *Feng, Ning, Zhang*, and *Zhou* (2022) investigate the relationship between investor inattention and earnings announcement effects around

Tomb-Sweeping Day, a Chinese holiday. Using a sample of listed firms from 2008 to 2019 that released earnings announcements on Tomb-Sweeping Day, the authors find many listed companies issue earnings announcements within two days before the holiday, and investor attention are distracted. The results show that earnings announcement effects exist around Tomb-Sweeping Day, and in contrast to the conventional view, there is a stronger post drift from negative earnings announcements than from positive ones. In support of the behavioural finance theory, the authors confirm that investor inattention causes earnings announcement effects.

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