Do more foreign strategic investors and more directors improve the earnings smoothing? The case of China

Meng-Wen Wu, Chung-Hua Shen, Chin-Hwa Lu

PII: S1059-0560(14)00177-4
DOI: doi: 10.1016/j.iref.2014.11.003
Reference: REVECO 993

To appear in: *International Review of Economics and Finance*

Do more foreign strategic investors and more directors improve the earnings smoothing? The case of China

Meng-Wen Wu
Department of Business Administration
National Taipei University
E-mail: mwwu@mail.ntpu.edu.tw

Chung-Hua Shen*
Department of Finance
National Taiwan University
E-mail: chshen01@ntu.edu.tw

Chin-Hwa Lu
Department of Finance
China University of Technology
E-mail: chleu@cute.edu.tw

Abstract

Since 2004, Chinese government requests the local banks to invite foreign financial institutions to be one or more of the large shareholders in the local banks. These foreign financial institutions are commonly referred to as the foreign strategic investors (FSIs), whose aim is to improve the performance and governance of the local banks. This study investigates whether FSIs can influence the earnings smoothing (ES) of local Chinese banks, which is dubbed as the "FSI effect". If such effect is observed, we examine whether the transmission is achieved through the "accounting quality channel" (i.e., more FSIs reduce Chinese banks' ES) or the "safety and soundness channel," (i.e., more FSIs strengthen these banks' ES). We use data from 102 local banks from 2006 to 2011 to examine the FSI effect and the two channels by considering banks with zero, one and two FSIs. Our results support the safety and soundness channel, indicating that more FSIs enhance ES and a stronger FSI effect for banks with more FSIs and more FSI directors.

Keywords: Foreign Strategic Investors; Income Smoothing; Loan Loss Provisions; Chinese Banks
JEL: C23; G14; M41

* Corresponding Author
* Sponsor: Taiwan National Science Council (NSC 102-2410-H-305 -025 -)