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Are stock price more informative after dual-listing in emerging markets? Evidence from Hong Kong-listed Chinese companies☆

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ABSTRACT

We study how the information and trading environments of Hong Kong-listed Chinese companies (H-share firms) change once the companies return to the China A-share markets for listing. We examine the stock price synchronicity, liquidity commonality, and stock liquidity after dual-listing and investigate three channels related to possible changes. We find that added A-share analyst coverage influences the stock liquidity, but not the price synchronicity or liquidity commonality. Moreover, Qualified Direct Institutional Investors' trading affects price synchronicity, liquidity commonality, and stock liquidity while Qualified Foreign Institutional Investors' trading affects price synchronicity and liquidity commonality, but not stock liquidity.

1. Introduction

In the 1980s and 1990s, many firms from emerging markets cross-listed their shares in developed markets such as the U.S. Previous studies find that cross-listings create value for firms by bonding managers to a higher standard of corporate governance, improving information environments, and improving stock liquidity (Karolyi, 1998, 2006). Those studies, however, examine cases involving firms from emerging markets cross-listing in developed markets. It is important to determine the potential benefits of cross-listing in emerging domestic markets, given their rising role in the global financial markets and economy. Dual-listings on the Hong Kong and China stock markets offer an excellent setting to examine these empirical issues. Unlike most cross-listings in other countries, many Chinese firms first list on a developed foreign market, especially the Hong Kong stock market (known as H-shares), and then return to their domestic A-share markets (known as A-shares) later. The advantage of studying this particular setting is that we need not control for country factors as in other studies. We can also rule out common explanations for cross-listings, such as the bonding theory (Coffee, 1999, 2002; Stulz, 1999), as they are not the focus of our study.

In this study, we use a sample of Hong Kong-listed H-share firms dual-listing on the domestic China A-share markets to examine the effects of dual-listing on stock price informativeness and stock liquidity. There are two competing views about the effects of the dual-listing of A-shares on information and trading quality. Regarding stock price informativeness, additional trading in the A-share market can help H-share prices to incorporate more firm-specific information. As financial analysts in China have

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the location advantage, they may produce more firm-specific information for H-share firms than outside analysts. As a result, information quality is expected to increase after dual-listing. However, the Chinese stock markets are dominated by retail investors who lack financial knowledge and skills, and herding behavior is prevalent especially in rising markets (Tan et al., 2008). Lai and Zhang (2015) observe intraday spillover of herding on cross-listed stocks between A- and H-share markets, such that A-share trading might add noise rather than new information to H-share prices. Several studies also show that financial analysts foster the production of market-wide rather than firm-specific information in emerging markets (Morck et al., 2000; Chan and Hameed, 2006; Fernandes and Ferreira, 2008). If H-share investors incorporate more market-wide information than firm-specific information in their trading, then information quality should decrease after A-share dual-listing.

A-share dual-listing may also increase or reduce the corresponding H-share stock liquidity. Pagano et al. (2002) argue that while some markets may be better than others in the production of liquidity, cross-listing may not always enhance liquidity due to market segmentation. An increased supply of equity shares may reduce the liquidity of existing shares in circulation. In contrast, Lee and Yuhong (2003) conduct several tests on the issuance of A-shares and its effect on the turnover of H-shares. They find that the issuance of A-shares either has no effect on or appears to raise the turnover of H-shares. This possible spillover effect on liquidity could result from the increased visibility due to the issuance of A-shares, a broadened investor base, and enlarged market capitalization, etc.[1] Thus, whether A-share dual-listing increases or decreases H-share liquidity is an empirical question.

We use stock price synchronicity, liquidity commonality, and stock liquidity to measure information and trading quality. We find that H-share price varies less with firm-specific information and more with market-wide information after A-share dual-listing. We consider three channels that may affect the information and trading quality of dual-listed H-shares. The first channel is the information produced by the added A-share analysts. Inconsistent with Chan and Hameed (2006) and Fernandes and Ferreira (2008), who find that securities covered by more analysts in emerging markets incorporate more market-wide than firm-specific information, we do not find evidence of the A-share analysts on the H-share stock price synchronicity. However, we do find that after dual-listing, although the liquidity of H-shares drops, the reduction is less for the H-share firms with higher A-share analyst coverage.

In general, A- and H-share markets are segmented in our sample period. The only legal channels that allow cross-border capital flows across Hong Kong and China's stock markets are the Qualified Foreign Institutional Investors (QFIIs) program, started in 2005, and the Qualified Domestic Institutional Investors (QDIIs) program, started in 2006. Our results show that the QDIIs' trading results in more firm-specific information being incorporated into stock prices. After H-share firms dual-list on A-share markets, however, the positive effect of QDIIs' trading on stock price informativeness drops. A similar finding is observed for the QFII program's effect on stock price informativeness. More QFIIs' trading in the A-share markets produces more firm-specific information. However, once the H-share firm is listed on A-share markets, the former incorporates less firm-specific information than before.

Finally, we find that H-share firms with greater H-share analyst coverage have higher investment-valuation sensitivity, and H-share firms with greater A-share analysts have lower investment-valuation sensitivity. We also find that more QDIIs' trading on H-shares leads managers to rely less on valuation to make investment decisions. This means that H-share firm managers must be capable of learning from stock prices.

This study contributes to the literature by examining a unique reverse dual-listing setting in China, and provides new evidence regarding changes in information and trading quality. However, unlike Chan and Hameed (2006) and Fernandes and Ferreira (2008), who find that additional foreign analysts foster the provision of market-wide information, we find that A-share analysts do not influence market-wide information. Our study complements related studies on A- and H-share firms, as they tend to focus on the period when A- and H-shares co-exist.[2] Recently, Li et al. (2015) show that H-shares incorporate more firm-specific information than their corresponding A-shares. We show that there is an increased spillover of market-wide information from A-share markets to H-shares once the latter dual-list on A-share markets.

Our study also has implications for financial-market regulators. In addition to dual-listings of H-share firms in China, the QFII and QDII programs and the Shanghai–Hong Kong Stock Connect have been opened to allow limited cross-market access. Although regulators generally take trading volume and market liquidity as indicators of the market's development, researchers raise concerns over the close connection between Hong Kong and China's stock markets.[3] However, if market liquidity stems from a decrease in informed trading, the market's reputation will deteriorate in the long run.

The remainder of this paper is organized as follows. Section 2 provides the institutional background for A–H dual listings, and Section 3 presents a review of the cross-listing literature. Section 4 describes the data collection details and variable construction. Section 5 provides the empirical results and Section 6 concludes the paper.

2. Institutional background

2.1. A–H dual listings

Although Hong Kong has been part of China since 1997, the former remains largely distinct from the latter in terms of its political, legal, and financial systems. Hong Kong's stock market is considered to be more developed, transparent, and sophisticated,

[1] Chan et al. (2013) show that the additional market-wide information available increases stock liquidity by reducing the adverse-selection cost of trading. Thus, if A-share dual-listing increases the production of market-wide information, it may drive more uninformed investors to trade H-shares.

[2] For example, Wang and Jiang (2004), Chan et al. (2010), and Seasholes and Liu (2011).

[3] For example, Sun et al. (2013a,b) show that the increased presence of mainland Chinese stocks in Hong Kong deteriorates the information environment of Hong Kong's stock market.