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Guest Editorial: Capital Market and Corporate Misbehaviour
China Financial Review International (CFRI)

Guest Editors' Biographies

Jia Liu (Business School, University of Salford)

Dr. Jia Liu is a Professor in Finance at the University of Salford, UK. She holds a Ph.D. in Economics from the University of Birmingham, UK. Her research interests focus on corporate finance, corporate governance, asset pricing, capital market, and economic sustainability and growth. She has widely published in international, SSCI-indexed journals, such as the International Review of Financial Analysis, European Journal of Finance, Journal of Business Finance and Accounting, British Accounting Review, International Business Review, and in many other publications.

Her research publications have decisively influenced research and practice in the areas of Corporate Finance, Corporate Governance, Capital Markets and the development of related public policy. Her research has won prestigious awards, including the British Academy of Management and European Management Journal Best Paper Prizes. She is Associate Editor and an Editorial Board member of several ABS-3 and 4-rated journals, including the British Journal of Management and British Accounting Review. An active committee member of the British Accounting and Finance Association and the British Academy of Management, she helps formulate public policy and vigorously stimulates debate, encouraging new thinking and innovation in the accounting, finance and business management communities. She influences current thinking and academic debate by delivering keynote addresses, by invitation, to international and national conferences, symposiums, and workshops. She has been frequently invited as Visiting Professor by universities in Europe, Africa and Asia.

Yuliang Wu (Management School, Bradford University)

Dr. Yuliang Wu holds a doctorate in Accounting and Finance from Manchester Business School and is senior lecturer in Finance at Bradford School of Management. His research interests focus on risk management in banking and asset pricing on stock markets. His research work has been widely recognised by leading academic journals, including *Journal of Banking and Finance*, *Journal of Future Markets*, *Journal of Financial Services Research*, amongst others. Governmental bodies, such as the Irish Banking and Payment Federation, fund his research. Dr. Wu was awarded the prize for promising young researchers in 2011 when he was employed by Queens' University Belfast. He has served as an external reviewer for grant applications in Qatar and China and as a referee for various international academic journals.

Moshfique Uddin (Business School, University of Leeds)

Dr. Moshfique Uddin is a lecturer in Accounting and Finance at Leeds University Business School, University of Leeds. He earned his Ph.D. in Accounting and Finance in 2008. His main research area focuses on institutions and economic policies in emerging markets; corporate finance and corporate policies and asset pricing in emerging markets; and International business and corporate restructuring in international financial markets. He has published in various leading journals, including *Journal of Business Research, R&D Management Journal, Business History, International Review of Financial Analysis, International Marketing Review, International Business Review, Applied Economics, Emerging Markets Review, Global Finance Journal and Research in International Business and Finance*, as well as in other national and international journals.

Introduction

China's capital market has achieved unprecedented development since its inception in 1990, making a massive contribution to economic growth and keeping China on course to become the world's large economy. This rapid development, however, has been coupled with huge swings in the stock market and frequent crashes, and the recent decline in the stock market has provoked speculation that the Chinese economic miracle may finally be coming to an end. Undoubtedly, the instability of the nation's stock market is often caused by corporate misbehaviour and a lack of market transparency, leaving investors embittered and mistrustful. Corporate misbehaviour, giving rise to corporate scandals, the abuse of arbitrage through imperfect systems, and immature and self-interest driven practice, have all contributed to recent investor distrust of the corporate sector and weak and unsound functioning of the capital market.

This Special Edition of *China Financial Review International* (CFRI) is devoted to exploring the issues surrounding corporate misbehaviour in the capital market and examining its interactions with other stakeholders in the financial market and banking sector. Our authors also seek to investigate the implications of these influences for investors' value creation, the sustainability of the capital market, the sound development of the banking sector, and, above all, to provide evidence to guide policy-making and practice.

This Special Issue comprises a collection of six peer-reviewed papers that contribute to the debate concerning corporate misbehaviour and value creation outcomes in the unique economic and market settings of China and Asia. Topics include the investment decision and the impact of firms' political connections; R&D investment and equity-financing constraints; the private investor's fair preference and recognition and stock return; and speculative stock trading and its influence on fair pricing. Our final paper investigates asset quality and profitability in the banking sector, considering the information gathering activities of corporate insiders and market players, as well as the functioning of the capital market and banking sectors.

Overview of the contributions

Market behaviour in China has attracted growing numbers of researchers in the past decade, and our first paper, by Junli YU and Jin Xin, adds to this body of work by seeking to determine the influence of executive networks and government governance on investment efficiency. The authors sample China's listed companies in developing their model and come up with some intriguing results. Contrary to the experience of Western market culture, they find that interventions by government and executive networks increase the efficiency of investment. While the executive network helps alleviate financial constraints and underinvestment, government governance provides institutional protection and restrains over-investment behaviour. Do these findings perhaps suggest that our Western, laissez-faire approach is out of date?

The second contribution, by Hu, Guoliu and Wang Yu, further the investigation of the significant role of Politics in China and its influence on markets. Do firms' political connections have any impact on stock price-crash risk? Using a large sample of Chinese firms, the authors conclude that such connections can reduce this risk. The effective determinant is the speed of bad news' confirmation, and they find that corporate political connections expedite this process. This mechanism affects corporate disclosure, and the authors claim that their results could help senior executives and investors make better decisions, thus avoiding stock price crashes.

The third paper, by Yang, Chaojun and Cui, Binxi, extends the field of inquiry by considering the influence that IPO suspension has on a firm's Research and Development investment. This ambitious project analyses data from firms across multiple industries, utilising the difference-in-difference-in-difference (DIDID) approach, concluding that firms subjected to IPO suspension are more likely to reduce such investment than those that are not. The authors claim to provide new, negative evidence of the link between R & D investment and equity financing constraints, which should act as a stimulant to governments to improve companies' public financing circumstances.

Research into Index Futures trading, by Dong, Shanshan and Feng, Yun, is the basis of the fourth paper in the series. This study considers whether this causes market fluctuations and looks at the effects of different parts (predictable and impact) of different types of speculative behaviour (intraday, medium-term and long-term). The authors find that an increase in intraday speculation increases the volatility of spot markets; and that long-term value speculation reduces this volatility, but that the shock of speculation has the opposite effect. Their advice to practitioners is therefore that they should limit speculative intraday trading while focusing on long-term value speculation, thus aiding stability and development of the market. In performing these analyses, they have advanced a new proxy for the speculation degree and input heterogeneous speculative behaviour into the HAR-RV model.

The penultimate paper by Zhu, Hongquan and Jiang, Lingling, records an empirical investigation to determine whether Merton's model of capital market equilibrium under incomplete information holds, employing a study of the Chinese stock market. Utilising the degree of shareholder base growth as a proxy for investor recognition, it examines the relationship between the latter and stock returns, applying Fama-MacBeth cross-sectional regressions on A-Share listed firms. In contrast to Merton's theory, their results indicate a non-linear and positive relationship between investor recognition and contemporaneous stock returns, and a negative relationship with future stock returns. Although Merton's theory is not fully reflected in the Chinese stock market, investor recognition is a significant risk factor here, providing the first evidence concerning the validity of this hypothesis in China's stock market.

Our final contribution gives us a comprehensive insight into some imminent issues faced by the banking sector. Nimesh Salike and Baio Ao use panel data to assess the impact of asset quality in determining banks' profitability, analysing evidence from 947 banks from 12 Asian economies during the period 2001-2015. Their findings demonstrate that poor asset quality has a significant negative effect on banks' profitability. Other bank features, such as capital adequacy, income diversification and operating inefficiency, are also important determinants of banks' profits. Macroeconomic factors play a role as well, with real GDP growth having the greatest impact on banks' performance. Interestingly, the authors' findings reveal that banks operating in non-advanced economies enjoy higher profit margins than those in advanced economies. Although the average asset quality in Asian banks has improved over the years, they observe that governments could promote more competition, particularly in non- advanced economies. Banks in the region are recommended to diversify their income by avoiding over reliance on interest income. This investigation is of particular importance to bankers and commercial stakeholders, since Basel III imposed more stringent requirements in banking regulation.

Conclusions

The contributions in this special issue have addressed a number of issues, with particular focus on the role of corporate ownership and corporate governance quality, market efficiency and transparency in different economic and market settings. On the whole, the findings of the papers point to the fact that corporate governance matters for value creation and therefore add significant insights to the literature. The findings reported in these papers have implications for policy and also the corporate sector.

The scope and depth of these studies give an indication of their novelty and originality and they do justice to the seriousness of this developing area of inquiry, given the growing importance of China in world finance. One day soon, movements on the Chinese stock market may well cause the world to 'catch a cold' and the significance of research into the causes and effects of speculation on this vast continent and beyond cannot be overstated. The 'credit crunch', which had its origins in America, has affected world economies for the past decade, and its effects are still being felt. If, a decade from now, the world enters another recession – or worse – as a consequence of a similar 'Chinese Bubble', research of the type we publish in this Special Issue should help to mitigate, or even predict and prevent the consequences of such a catastrophe. Policy makers should be alert to the issues raised by the growth of market trading in China and the fundamental instability of some of its processes. We hope these papers raise their awareness.