Guest editorial: The ever-changing market in China

Introduction

China's capital market has witnessed remarkable growth and reform in recent years, emerging as a key player in the global financial arena. Recent research has highlighted the challenges and opportunities presented by the ever-changing capital market in China (Han *et al.*, 2018; Cheng *et al.*, 2022; Lennox and Wu, 2022). On the one hand, the evolving landscape offers domestic and international investors vast opportunities to access a broader range of financial instruments and investment opportunities. On the other hand, market participants must navigate the complexities of new regulations and evolving risk factors. A call has been made for research on the broader implications of China's evolving capital market on the global financial system (Carpenter *et al.*, 2021). As China continues to open up its capital markets to international investors and plays a larger role in cross-border financial activities, it becomes an integral part of the global financial landscape. This integration brings global investors and businesses opportunities while presenting regulatory harmonization and risk management challenges.

Moreover, the ever-changing capital market has implications for various stakeholders. Businesses operating in China must adapt to the dynamic financial environment, consider new financing options and manage risks associated with market fluctuations. Investors face the challenge of staying well-informed about regulatory changes and assessing the impact on their investment strategies. The research on the ever-changing capital market in China provides valuable insights into the transformative journey of the Chinese financial system. Understanding these changes' drivers, regulatory dynamics and implications is essential for investors, businesses and policymakers seeking to navigate the opportunities and challenges in this dynamic and influential market.

China's economic reforms and opening-up policies have paved the way for the expansion and internationalization of its investment and capital markets. Key aspects of investment and the capital market in China include the following:

- *Foreign direct investment (FDI)*: China has been a magnet for FDI, attracting significant capital from multinational corporations seeking access to its vast consumer base and low-cost manufacturing capabilities (Morck *et al.*, 2008). The Chinese government has introduced various policies encouraging FDI inflows, including establishing free trade zones, streamlined business registration processes and improved intellectual property protection.
- *Equity and debt capital markets*: China's equity and debt capital markets have increased recently. The Shanghai Stock Exchange and the Shenzhen Stock Exchange are the primary stock markets where Chinese companies can list their shares. The issuance of corporate bonds and other debt instruments has also expanded to meet the funding needs of businesses and local governments (Jiang *et al.*, 2020).
- *Regulatory reforms*: China has undertaken significant regulatory reforms to enhance its capital market infrastructure and attract domestic and foreign investors. These reforms include adopting international accounting standards (IFRS) and implementing measures to improve corporate governance, transparency and investor protection.

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- *Market liberalization*: China has taken steps to liberalize its capital market, allowing greater participation of foreign investors. Qualified Foreign Institutional Investor (QFII) and Renminbi QFII (RQFII) programs enable qualified foreign investors to access China's capital markets (McGuinness *et al.*, 2017; Liao *et al.*, 2023). The Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect programs facilitate cross-border investment.
- *Belt and Road Initiative (BRI)*: China's BRI, aimed at fostering economic and infrastructure connectivity between China and other countries, has increased investment opportunities and cross-border capital flows (Huang, 2016).
- *State-owned enterprises (SOEs) and privatization*: SOEs play a significant role in China's capital market.

The government has been undertaking efforts to reform and restructure SOEs to increase efficiency and attract private capital (Lin *et al.*, 2020). Privatization has been pushed in certain sectors to enhance market competition. Despite significant progress, China's capital market still faces challenges. Market volatility, concerns over corporate governance, information disclosure practices, and market manipulation remain areas of focus for regulators and investors.

We organized the special issue symposium on 17 December 2022 with the theme "Ever-changing market in China" to generate discussion on emerging issues. The conference invited Distinguished Professor Luo Zuo as the keynote speaker, who shared his knowledge, experiences and thoughts on accounting research opportunities in China. We saw a line-up of experts from China, Australia and New Zealand who promoted incorporating new technology, regulatory framework and innovation as part of China's capital market research. The main content featured in this special issue predominantly comprises manuscripts originally presented at the conference.

This special issue introduces fresh ideas and contemporary themes relevant to China's capital market research. Comprising seven diverse contributions, it delves into a wide spectrum of topics, research contexts, organizational viewpoints and theoretical and practical insights. These contributions offer valuable reflections on how corporate finance, reporting and governance impact China's transitioning economy while providing crucial lessons and insights for the future of accounting and accounting practices. The contributions are grouped into information disclosure, auditing and corporate finance to structure the content effectively. Within each category, the published papers in this special issue are examined in light of emerging themes, allowing for a comprehensive exploration of the subject matter.

Information disclosure

Chinese markets have recognized the importance of transparency in attracting investment, and regulatory initiatives have played a vital role in shaping better disclosure practices. As these markets continue to grow and integrate into the global financial system, efforts to improve disclosure will likely remain a priority to instill confidence and support sustainable growth. Two papers are related to public disclosure and disclosure policy in China's market. Duan *et al.* (2023) investigate the impact of peers' media coverage releases and investor heterogeneity on Chinese A-shares listed on the Shanghai and Shenzhen Stock Exchanges between 2010 and 2019. They use support vector machine technology to categorize positive, neutral and negative news about industry leaders from prominent Chinese online financial outlets and the Chinese financial press. The authors discover that positive and negative news about leaders initially caused peers' stock prices to rise, but this effect reversed within

one quarter. When leaders' shares receive positive news coverage, institutional investors display excessive abnormal buying pressure on peers' shares, leading to overreactions. Retail investors do not actively trade on peers' shares on leaders' news days due to limited attention. These findings shed light on investor behavior in response to media coverage and hold implications for the information environment in China's capital market. Market participants, including corporate executives, investors and financial analysts, can benefit from the practical relevance of this research.

Jiang and Tang (2023) examine the impact of the mandatory adoption of The Act 2013 in the UK on voluntary carbon disclosure. The study reveals a notable increase in the quantity and quality of voluntary carbon disclosure in the treatment sample compared to the control sample. Moreover, companies exhibiting better environmental, social and governance (ESG) performance experienced a significantly higher rise in voluntary carbon disclosure after implementing The Act 2013. Moreover, firms operating in carbon-intensive sectors showed a more pronounced increase in the tendency for voluntary disclosure following the Act's adoption compared with less carbon-intensive sectors. These findings, derived from a developed market, hold crucial policy implications for China's market by shedding light on the factors driving carbon disclosure in response to regulatory rules. Currently, carbon disclosure remains a voluntary practice in China. As of 2020, only 39.02% of listed firms participating in emissions trading schemes chose to disclose carbon-related information in their annual reports. However, the credibility and comparability of the provided carbon information are not assured, given the absence of compulsory third-party certification for these disclosures. Jiang and Tang (2023) demonstrate a noteworthy surge in the quantity and quality of voluntary carbon disclosure following the mandatory adoption of The Act 2013 in the UK. This finding underscores the effectiveness of mandatory carbon reporting and offers promising prospects for the Chinese market. In light of these results, the authors recommend that China consider implementing mandatory carbon disclosure regulations gradually. Such regulations would enhance transparency and improve emissions management practices, ensuring more reliable and standardized information on carbon emissions.

Auditing

The growth of the auditing market in China has been a remarkable and transformative journey, mirroring the country's economic expansion, financial market liberalization and regulatory changes. Over the past few decades, China's auditing industry has undergone substantial transformations characterized by heightened professionalism, increased regulatory scrutiny and global integration. This progress has drawn the attention of two papers, which delve into the issues of the Chinese auditing market.

Kong and Huang (2023) study how auditors respond to share pledging by listed firms in China's market. The authors used an audit pricing model to gauge the relationship between the proportion of shares pledged by the listed firm's controlling shareholder and audit fees. The study reveals a positive association between audit fees and the extent of share pledging by the controlling shareholder. Furthermore, the results provide novel evidence that this positive association between audit fees and share pledging could be moderated if the firm is listed on the main board or a state-owned enterprise. Firms with pledged shares and abnormal audit report delays had higher audit fees than their counterparts without prolonged delays. These findings hold important practical implications for those overseeing corporate governance; boards must thoroughly grasp the adverse consequences of share pledging as a significant financing method for the firm. The study also has policy implications for stock market regulators like the China Securities Regulatory Commission.

As suggested, regulators might consider establishing disclosure thresholds and pledge ratio requirements based on factors like a firm's listing status and ownership structure to address share pledging concerns.

Bu *et al.* (2023) examine how auditors respond to the increase in earnings management observed after the split-share structure reform (SSSR) in China. The researchers analyze auditors' tendency to issue modified audit opinions (MAOs) after the SSSR. The findings indicate that non-Big10 auditors in China are less likely to issue MAOs to economically important clients who seem to engage in earnings management following the SSSR. However, when nontradeable shares are released to the markets, Big10 and non-Big10 auditors are less likely to issue MAOs to economically important clients involved in earnings management. These findings suggest auditors may have compromised their independence in response to earnings management after the SSSR, likely because of pressure from economically important clients. The study sheds light on the evolving reporting behavior of auditors, particularly concerning their independence, in the Chinese market. It also contributes to the growing body of literature on the impact of institutional changes on auditing practices worldwide.

Corporate finance

Corporate finance in China revolves around capital-raising activities to finance business operations, expansion and investment projects. China has undertaken capital market reforms to improve corporate finance efficiency and transparency. These reforms include enhanced corporate governance standards, improved financial reporting practices and increased regulatory oversight to protect investor interests and market integrity. Technology and financial innovation have been significant in shaping corporate finance in China. The rise of fintech has introduced digital payment solutions, online lending platforms and innovative financial products, enabling companies to access finance more efficiently. Overall, corporate finance in China reflects the country's economic dynamism, evolving regulatory landscape, and efforts to create a more robust and investor-friendly financial system. The continuing growth and development of China's corporate finance sector are integral to supporting the country's economic growth and sustainable development in the global financial ecosystem.

Three studies examine investment and capital market behavior. Since 1978, China has emerged as the third-largest country for outward foreign direct investment (ODI), trailing only the USA and Japan. Nevertheless, limited empirical research has been conducted to comprehend this phenomenon fully. Thus, Tong *et al.* (2023) reveal a strong correlation between Chinese ODI stocks and variables, such as market size, trade and natural resources, based on a panel data sample from 2003 to 2012, encompassing 176 host countries. Their findings suggest that market and resource-seeking objectives motivate China's ODI decisions. These results significantly affect investors and regulators worldwide concerning trade policies and globalization. China is the largest emerging market. Host countries can adopt strategic measures, such as reducing trading barriers and implementing tax-friendly policies, to attract more substantial Chinese ODI and stimulate their economic development. China and host countries can leverage this knowledge to foster mutually beneficial economic relationships and promote international trade by understanding the drivers behind Chinese ODI.

Since the 2008 global financial crisis, researchers have increasingly focused on understanding stock price crashes in asset pricing and corporate finance frameworks. Prior studies have used ordinary least squares and logistic regression techniques to measure crash probability and determine crash determinants. However, given the unique characteristics

of the Chinese stock markets, existing literature on the determinants of stock price fluctuation in China has yielded mixed results. Wang *et al.* (2023) take a different approach and use artificial neural networks (ANN) to predict stock price crashes in the Chinese equity market. ANN is a powerful machine-learning algorithm commonly used for solving complex problems (Gu *et al.*, 2020). They developed three ANN models to outperform traditional logistic regression, incorporating critical variables specific to Chinese markets to predict stock price crashes. The study uses a sample of 1,400 crash observations and 16,848 noncrash observations, comparing the ANN models' forecasting performance with the traditional logistic model in China's vast emerging market. The evaluation was conducted using receiver operating characteristics curves, the area under the ROC curve and other conventional performance evaluation methods. In summary, Wang *et al.* (2023)'s study delve into the "black box" of stock price crashes, providing a comprehensive understanding of potential contributing factors in the Chinese stock markets. Their innovative use of ANN advances the prediction of stock price crashes and opens new avenues for research in this domain.

Improving economic development efficiency is a top national priority in the Chinese economy's current "new normal" phase. However, achieving economic growth is hindered by several challenges and contradictions, including investment bubbles, high leverage ratios and income inequality. China's Securities Law holds directors and officers (D&Os) of firms jointly liable for compensation if they provide false information in corporate documents, resulting in losses to investors. Consequently, D&Os are exposed to significant legal and financial risks and must demonstrate their innocence to avoid adverse consequences. Li *et al.* (2023) conducted a study to examine the impact of D&O insurance on corporate governance and investment decisions. Analyzing Chinese A-share listed firms from 2007 to 2020, they discovered that purchasing D&O insurance negatively affects corporate investment efficiency, particularly in cases of over-investment. Nonetheless, a strong internal governance mechanism, proxied by the shareholding ratio of the largest shareholders and the internal control quality index, can help alleviate the negative impact of D&O insurance on investment efficiency. The influence of D&O insurance on investment efficiency is channeled through corporate financing constraints. This study has significant implications for developing the Chinese insurance market and corporate governance practices. The authors recommend that listed firms carefully assess their unique circumstances and characteristics when choosing D&O insurance. However, insurance companies should develop liability insurance policies that align with China's institutional environment and firms' specific traits. By working together, insurers and insured firms can ensure that D&O insurance effectively serves its purpose by enhancing listed firms' monitoring and safeguarding the interests of minority shareholders.

Summary

China has become the second-largest economy in the world, with increasing participation in international political and economic affairs. However, the Chinese institutional setting differs considerably from Western countries, including its financial and political systems. The Chinese capital market has attracted increasing academic attention worldwide, which has led to the formulation of novel accounting and finance research questions. The rapid growth of the Chinese capital market bears strong marks of "Chinese characteristics." This special issue significantly contributes to the accounting and finance literature by expanding and advancing our understanding of contemporary accounting and finance issues in China, which plays a critical role in an ever-changing global market.

However, ever-changing regulations (e.g. the BRI, the Strategy of Targeted Poverty Alleviation and the Acts of Environment Protection) and business environment (e.g. stock market volatility and turnover, development of government bonds and reforms of the stock

market) bring new anomalies and challenges to the capital markets. Thus, over the past few decades, China's executives, accounting and auditing industry have experienced substantial changes marked by increased professionalism, regulatory oversight and internationalization. These changes in the Chinese capital market call for more research into the market behavior and regulatory framework.

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