Profit Warings and Market Efficiency: Evidence from Chinese Stock Market

Abstract

In the end of 2001, China Securities Regulatory Commission imitates the disclosure regulations of mature stock markets and forces listed companies to issue profit warnings before earnings announcement if they expect reporting a loss or profit changing a lot. The disclosure policy are aimed at decreasing the price fluctuation of earnings announcements, decreasing information asymmetry, protecting small investors' benefit, and improving market efficiency. In this paper, we focus on the firms with extremely large earnings surprise, both negative and positive, and investigate the effect of profit warnings on market reaction. We find that profit warnings do make earnings information to be reflected in price earlier and reduce market reaction to earnings surprise. However, it may not reduce price fluctuation or improve market efficiency. The cumulative abnormal return of 20 calendar days after earnings announcement is significantly negative when the earnings surprise is positive and significantly positive when the earnings surprise is negative. Given the insider trading pervades Chinese stock market, we think this policy may give it more space.