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INVESTOR PROTECTION, FIRM FUNDAMENTALS INFORMATION, AND STOCK PRICE SYNCHRONICITY

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ABSTRACT

This thesis entails a cross-country study on the use of firm fundamentals information (FFI) in capital market pricing decisions and the role investor protection (IP) institutional arrangements play in enhancing the use of FFI in capital markets. I first examine the association between IP and SPS across the 40 countries of Morck Yeung and Yu (MYY) (2000) from 1995 to 2010. This is followed by a study of the association between FFI and SPS and the complementing effects of IP on this association.

MYY study the use of FFI by the capital market in making investment decisions. They use stock price synchronicity (SPS) measures as indicators of the use of FFI by the market. SPS is the tendency of share prices to move in the same direction in a given period of time. They posit that when the information environment in a capital market is more developed, investors would use FFI of firms in making investment decisions and this would lower SPS. Conversely, when the information environment in a capital market is less developed, investors would rely on market information in making investment decisions and this would increase SPS.

To test the use of FFI they examine the association between SPS and country development (CD), IP, and FFI variables. They do not find any conclusive evidence of the direct association between FFI and SPS, but find that CD and IP are negatively associated with SPS. They also find that CD and IP are both proxies of the general quality of the information environment, with IP being the more effective of the two. Therefore, they conclude that better IP improves the information environment and hence lowers SPS.

MYY's analysis covered only one year, 1995. Since 1995, three major global economic crises have occurred, the Asian Financial Crisis (AFC), the Dotcom Crisis and the Global Financial Crisis (GFC). Many countries have responded to these crises by improving their IP oversight system. This provides further motivation for assessing the beneficial effects of IP on the information environments of capital markets around the world.

I find that, in general, IP is a consistent determinant of SPS across the 40 countries over the sample period 1995 to 2010. However, the change in SPS across years is only explained by the change in stock market development (SMD) proxied by the natural log of number of companies in a market, and that is also limited to the time segment 1995-2005.

For the association of FFI with SPS, I find no consistent association between SPS and FFI that are used in previous studies as a proxy for firm performance risk. However, I find an FFI construct known as accruals to be associated with SPS when IP levels are high. Accruals greatly enhance the amount of information on accounting statements with respect to the future economic benefits of a firm. These results suggest that IP has a complementing effect on the association between FFI and SPS, which suggests that investors rely on FFI in making investment decisions instead of market movements when IP is better.

I conclude that IP is a strong and consistent determinant of quality of the information environment of countries, and better IP arrangements lead to a greater use of FFI in investment decision making. This study would assist in better understanding the information environments of the capital markets around the world. It sheds light on the information dynamics both within a country and at a cross-country level, thus helping in the formulation of regulations that are more effective in achieving market transparency.

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LIST OF ACRONYMS

AAI	-	Accrual Accounting Information
AFC	-	Asian Financial Crisis
CD	-	Country Development
CLERP	-	Corporate Law Economic Reforms Program
CG	-	Corporate Governance
CoC	-	Control of Corruption
Com	-	Co-movement
DSI	-	DataStream International
FFI	-	Firm Fundamentals Information
GDP	-	Gross Domestic Product
GE	-	Government Efficiency
GFC	-	Global Financial Crisis
IP	-	Investor Protection
IASB	-	International Accounting Standard Board
IFRS	-	International Financial Reporting Standards
MICG	-	Malaysian Institute of Corporate Governance

OECD	-	The Organization for Economic Cooperation and Development
PS	-	Political Stability
R^2	-	Co-efficient of Determination from the Market Model
RoL	-	Rule of Law
RQ	-	Regulatory Quality
SMD	-	Stock Market Development
SOX	-	Sarbanes Oxley
SPS	-	Stock Price Synchronicity
SYNCH	-	Stock Price Synchronicity
V&A	-	Voice and Accountability
WSE	-	Warsaw Stock Exchange