Accounting disclosure, stock price synchronicity and stock crash risk

An emerging-market perspective

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Abstract

Purpose – This study aims to examine the effects of firms' accounting disclosure policies on stock price synchronicity and stock crash risk, using a sample including 13 emerging markets. Furthermore, this research investigates how these relationships are affected by country-level investor protection and firm-level governance rankings.

Design/methodology/approach – This paper uses accounting disclosure measures constructed based on survey questions by Credit Lyonnais Securities Asia (2001, CLSA). The accounting disclosure measure is used to explain the two dependent variables, stock price synchronicity and stock crash risk. The stock price synchronicity measure is defined as the logistic transformation of R^2 following Hutton *et al.* (2009) and Jin and Myers (2006). R^2 is taken from the estimation of an extended market model. The stock crash risk variable is measured as the frequency difference between extremely negative and positive stock return residues following Jin and Myers (2006). These stock return residues are taken from the estimation of an extended market model. Because the CLSA firm-level disclosure data are from 2000, this paper matches other data taken from the same year, for consistency. The final sample includes 204 observations in 13 emerging countries.

Findings – This paper finds that firms' stocks are less synchronized with the entire market and have less crash risk if firms have superior accounting disclosure policies. These results suggest that the cost to collect firm-specific information may be decreased for investors if firms are more transparent. Thus, these firms' stocks have more firm-specific information content. These results also suggest that management is less likely to hide some negative information and release such negative information suddenly in the future if firms have higher levels of accounting disclosure. Thus, these firms' stocks are less likely to crash. In addition, the influences of firms' accounting disclosure policies on stock price synchronicity and crash risk are more significant for firms with superior country-level investor protection and firm-level governance rankings. These results imply that external investors place more value on accounting disclosure by well-governed firms because firms with superior governance standards are less likely to intentionally disclose misleading information. Thus, these firms' stocks can incorporate more firm-specific information and have less crash risk.

Originality/value – The current study is the first to show that the effects of accounting disclosure on stock price synchronicity and crash risk are more pronounced for firms with superior country-level investor protection and firm-level governance standards. Thus, this research extends the literature by providing a comprehensive picture of the influences of accounting disclosure on stock markets. In addition, the existing literature (Chen *et al.*, 2006; Durnev *et al.*, 2004) shows that firms with lower stock price synchronicity are associated with higher investment efficiency because managers invest based on the information in stock prices. Obviously, higher stock crash risk is highly related to higher bankruptcy risk for firms. Thus, examining the effects of accounting disclosure on stock price synchronicity and stock crash risk is of obvious importance to policy makers.

Keywords Emerging market, Accounting disclosure, Stock crash risk, Stock price synchronicity

Paper type Research paper