

Report on r^2 as a measure of firm- specific information



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Report on RE as a Measure of Firm-Specific Information at Cross-Country

Level 1 . Introduction This report is based on the literature of Elves et al. (2010) to critically examine the idea of whether RE can be a good measure to evaluate the information environment quality at cross-country level. Elves et al. (2010) made an argument on whether the measure of RE was adequate to evaluate the quality of cross-country Information environment based on the research of Merck et al. 's (2000). Elves et al. (2010) summarized the main Ideas of Merck et al. 's literature at the beginning of their article and also presents some prior researches on RE.

In most prior researches, such as Merck et al. 's (2000), experts believed that corporate stock prices were more likely moving together in poor condition of economies than in rich economies. Since poor economies tend to have less strong property rights and corporate governance as well as the enforcement mechanisms with less efficiency, thus the prices are more easily co-move with the market. (Elves et al. , 2010) Also In the literature of Moor, Young and You (MY, 2000) claimed that RE and other meaner of stock market synchronicity are higher in countries with lower GAP and poor financial systems.

Non, Myers, 2006) However, does the RE always reflect the accurate information? Some other studies proposed their idea that there is another possibility that at the beginning the amount of firm-specific uncertainty is high which results in low RE, whereas the uncertainty may cause high RE in the future. (OTOH, Yang, Ghana, 2007) This report critically evaluates the debate about the reliability of RE at cross-country level. In the second

section, the contribution of the study will be presented. The Third section will discuss the importance of RE study for the direction of future research.

The fourth section will critically evaluate the reliability of RE in multinational circumstances. At last but not least a conclusion of this report will be summarized.

2. The Contribution within a Developing Body of Research

As the appearance of high frequency and vanishing barriers of International trade as well as the capital mobility is increasing, so that the need of country-specific information is increasing, and a better understanding of international stock market for investors is necessary. (Elves et al. 2010)

Meanwhile regulators are doing their best to harmonize both sides of capital market regulations and financial reporting rules. (Elves et al. , 2010) Thus the

study of the information environment quality both within country and at cross-country level can help understanding the dynamics of information and

formulate regulations. (Elves et al. , 2010) A good example which can explain the importance of cross-country level information is cross-list

companies, such as a non-U. S. Company cross-list on the U. S. Exchange market. In prior researches, there are some studies examine that a cross-

listing firm can improve the incentives for different market participants and private information on trading, cause cross-listing companies are committed

to a higher level of Information disclosure environment. Thereby It Influences a company's stock price. (Fernando, Ferreira, BIBB) Also, there are

evidences showing that a strong asymmetric relation is between cross-listing condition and the stock return variation of a company. Fernando,

Ferreira, 2008) Therefore an adequate measure of evaluating information quality is necessary, especially at cross-country level. Also, a stock market

with functional efficiency is associated with a necessary condition which is the share prices are closely connected with firm fundamentals. According to the research of Roll (1988), the way that capitalizing fundamentals information into stock prices through the activities of risk arbitrageurs' trading is vitally significant, of which indicates to a low RE.

And there are researches present that firm-specific stock prices are positively related to the innovativeness of stock prices, at the same time a link has been discovered between stock markets with better function and larger firm-specific return. (Turned, Moor, Young, Carolina, 2003) Thus the research on RE at cross-country level for firm-specific information fills in the gap of the study on information quality measures between those two conditions (cross-country condition and firm-specific condition). 3. The Importance for the direction of Subsequent Research 3. Impact on Research themes In prior studies, most literatures agree RE is the adequate measure of information environment quality. Most subsequent research in the area related to information environment considers RE as a reliable measure of information evaluation. (Elves et al. , 2010) Therefore those research was based on the previous research result of RE. For instance, the research topics about stock price synchronicity were generally applying RE as their support of discussions. There are topics talking about the relationship among stock prices synchronicity, crash risk and institutional investors.

Meanwhile there also are topics around stock prices synchronicity and trading in emerging markets or firm-specific information. All of those topics above and even more researches are on the basis of the previous research on RE which indicates RE is the adequate method to examine whether the <https://assignbuster.com/report-on-r2-as-a-measure-of-firm-specific-information/>

information quality is poor or rich. However after some questionable opinions have been proposed, some other directions of research appears. Some researchers start raising questions on RE, such as the discussions on whether RE is noise.

Therefore, once RE has been examined to be inadequate, those researches based on RE will be reevaluated. And some discussion topics will appear to figure out the actual adequate measure instead of RE especially on cross-country level.

3. 2 Impact on Method level

In the literature of Elves et al. (2010), researchers made some differences in collecting samples when they used metrics and samples to construct their research. Even though their research was also based on prior research of Merck et al. s (2000), Elves et al. (2010) lengthened the time period of data within the same countries in Merck et al. s (2000) article in order to assist comparability. And all the duplicate records had been deleted for every country to keep the countries' original observation. There were several issues excluded, such as secondary issues, companies can not provide all the required information, and firms with less than 26 weekly observations for returns in one year. (Elves et al. , 2010) Some foreign companies in particular markets also had been excluded as well for the aim of reducing the influences from provenance factors. (Elves et al. , 2010) And another difference between Elves et al. s (2010) sample and previous research is that in Elves et al. 's (2010) literature included extreme returns for the purpose of properly capturing all the information effects. The difference in collecting data and sample will cause different research results. The changes made from old method gives later researches more consultation, comparison and

thinking. Despite discussing about the perfection of the method, the way that Elves et al. (2010) evaluated the sample indeed specified ND wider the consideration of data collection.

And these changes also might help wider the thinking models in the subsequent researches. 3. 3 Impact on Philosophy level The result was presented that RE is inadequate in Elves et al. 's (2010) research on the analysis of RE acting as a measure of information quality at cross-country level. This conclusion is driving the theories about RE into a different direction from most previous studies. So far, most discussions about firm-specific information and stock prices synchronicity are applying RE to support their ideas.

And some important conclusions had been settled under the assistant of RE statistics method. For example, high IRS being observed in two circumstances: one is that investors treat companies equally when the information on firm level is so poor that companies can not be distinguished; and the other one is when companies are all large and well diversified. (Elves et al. , 2010) However, after the effect of RE in evaluation information has been changed, some theories like above may changed as well. Then some theories and philosophies may have to redefine. 4. Critically Evaluation on the

Reliability of RE at Cross-Country Level In the literature of Elves et al. (2010), an analysis on RE as a measure of information had been presented, of which result in a conclusion that RE is not an appropriate method in evaluating firm-specific information at cross-country level. This conclusion has

subverted the major idea of prior research. A major representative of the RE approving opinion is the literature of Merck et al. (2000). Even though Elvess et al. 's (2010) article is based on the result of Merck et al. (2000), Elvess et al. (2010) has an opposite direction of opinion from Merck et al. (2000). The use of RE as a measure of information is based on the assumptions that the corporate governance and the regimes of protection of investors are stable. However, those factors can change quickly and unpredictably in the real world, thereby changes the RE. (Elvess et al. , 2010) Also the problems of aggregation and disaggregating have been revealed. (Elvess et al. , 2010) It was demonstrated by data that aggregation model will reduce RE, because in a cross-country condition, use RE meaner fitting one model to n countries which is not objective.

And in terms of segregation, it is also difficult to believe that the information under different evaluating circumstances are of similar quality. (Elvess et al. , 2010) Further more, Elvess et al. (2010) are not the only ones who hold the disapproval opinion on RE as a measure of evaluating information. OTOH et al. (2007) also questioned about whether RE is noise. They made a test on the relation of RE and market efficiency, and examined the combination between RE and stock price innovativeness. All the results were indicating that RE is not an adequate measure of firm-specific information quality. (OTOH, Yang, Ghana, 2007) 5.

Conclusion This report critically examined the idea of RE as a measure of firm-specific information at cross-country level. Also present the contribution of this study for development AT research, Ana Its coalescence Tort alerting consequent research as well. Although RE has been applied for evaluating <https://assignbuster.com/report-on-r2-as-a-measure-of-firm-specific-information/>

information environment quality for a long time and has been approved by a lot of experts, after the improved method of sampling and critically review of other literature, the inadequate of RE using in this area has been proved.

The usefulness of RE as a single indicator for evaluating information quality can not be ignored.