



The appraisal of ordinary shares by Chinese financial analysts

Appraisal of
ordinary shares

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Abstract

Purpose – The purpose of this paper is to provide insights into recent financial analysis practice in the Chinese context. The paper aims to examine the approaches pursued and information used by Chinese financial analysts in investment appraisal of ordinary shares. The research seeks to explore influences upon analysts' decision making and how analysts perceived the Chinese investment environment.

Design/methodology/approach – A questionnaire based survey approach was used, conducted in 2003 with 65 Chinese financial analysts.

Findings – The findings indicate that fundamental analysis was the predominant technique adopted in appraising equities in line with the development of institutional investors and improved market efficiency. Regarding information used to analyse companies, annual reports constituted the most influential source. The Chinese analysts favoured usage of International Financial Reporting Standards (IFRSs) and International Accounting Standards (IASs) by A-share companies. The findings indicate changes within the financial analyst community, suggesting pressure for higher quality analysis and increased use of more sophisticated techniques despite ongoing market shortcomings. Opinions vary as to how important financial analysis is in influencing stock valuation or, crucially, socio-economic welfare. However, studies putting the analysts' role in perspective *vis-à-vis* other forces contribute to broadening understanding of this significantly under researched area. This current study contributes to filling this gap.

Originality/value – This paper provides insights into how specific country contexts influence financial analysts' investment appraisal practice in interims of incentives, information sources and techniques adopted.

Keywords Financial analysis, Equity capital, Accounting, Shares, China

Paper type Research paper

1. Introduction

Globalisation, the global institutionalisation of the equity market and the internationalisation of accounting standards are phenomena indicating the importance of researching the appraisal methods used by financial analysts. Financial analysts are the principal users of and intermediaries in securities information in various international markets (Olbert, 1993; Barker, 1998). China's economy has undergone transition from a substantively planned economy towards a "socialist market-oriented economy with Chinese characteristics" (World Bank, 1997, p. 2). This process was accelerated after China's accession to the World Trade

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Organisation at the end of 2001. In 2002, the introduction of the Qualified Foreign Institutional Investors (QFII) scheme jointly by the China Securities Regulatory Commission (CSRC) and the People's Bank of China (PBOC) became a key factor in the liberalisation of the Chinese domestic financial market. The removal of international investment restrictions increased interest in investment in China (Olbert, 1994; Heilmann, 2002). The Chinese stock market has been characterised as a policy-driven market in which political calculations, policy missions and administrative interference are more important than the dynamics of market competition in determining price fluctuations (Heilmann, 2002). In line with Chinese economic reform, Chinese accounting has been driven towards internationalisation (e.g. Tang *et al.*, 1996; Biondi and Zhang, 2007; Suzuki *et al.*, 2007). In order to investigate ordinary share appraisal by financial analysts in China over recent times, specifically after 2002, the year that marked a key moment in the liberalisation of the Chinese market, we conduct a questionnaire survey of 145 Chinese financial analysts. The objectives of this paper are as follows: first to gain insights into how the Chinese context has influenced information usage and appraisal techniques adopted by analysts, further indicating how Chinese analysts understand that context? Second to investigate the role of accounting information in their decision-making process, especially in relation to the relevance and importance of different accounting standards?

Behaviourally based studies of appraisal techniques and information sources used by analysts are relatively scarce and substantively focused on non-domestic Chinese analysts (Moyes *et al.*, 1997; Wong and Cheung, 1999; Lu, 2001). The focus has typically not been on mainland China but on Hong Kong and Taiwan[1]. An exception is the work of Hu *et al.* (2003a), upon which the current study builds and extends[2]. Hu *et al.* (2003a) provides some insights into information sources used by mainland Chinese financial analysts and their understanding of accounting information quality. In so far as Hu *et al.* (2003a) point (relative to US and UK contexts) to a greater emphasis by analysts on public information less emphasis on direct investigation and a greater emphasis on accounting disclosure relative to other information, their results are consistent with our study[3].

Theories in finance support the existence of active financial analysts in an efficient market (Lorie *et al.*, 1998; Cornell and Roll, 1981; Grossman and Stiglitz, 1980; Schipper, 1991): a micro-level study permits exploration of the phenomenon closely. Acknowledging the real world assumption that information involves costs, Barker (1998) argues that analysts conduct informed analysis filtering information to make public anything of value relevance, thus providing a benchmark against which fund managers can test their own private sources. Exploring the detail of analyst practice internationally helps us to assess dimensions of the functioning of the global capital market.

2. Characteristics of the Chinese financial market and accounting standards, information intermediaries

The literature suggests that analyst behaviour is influenced by country-specific factors including the size and activity of the country's equity market, national professional requirements and the presence or absence of large international brokerage and investment firms (Moyes *et al.*, 2001). Due consideration is given here to macro- and micro-factors that may influence the behaviour of analysts in China, including specific features of China's stock market and accounting standards, the development of information intermediaries and cultural influence.

From 1978, China's securities market gradually developed under the guidance of Deng Xiaoping's Theory and reforms, and an opening up to the outside world consistent with the socialist market economy's development has ensued. Mainland China in the 1990s developed two stock exchanges, located in Shanghai and Shenzhen. Both of exchanges are non-profit-making membership institutions directly governed by the CSRC. Shares listed on the stock exchanges in China are divided into two broad categories: non-tradable and tradable. Non-tradable shares may be categorised as:

- (1) shares owned by government[4];
- (2) shares owned by legal persons; and
- (3) shares owned by employees and other individuals.

Tradable shares include:

- (1) A-shares;
- (2) B-shares; and
- (3) H-shares.

A-shares were originally designated for purchase and trading by the local Chinese, and are denominated in the Chinese currency, the Renminbi Yuan. Companies issuing A-shares have prepared financial reports complying with domestic GAAP issued by the Ministry of Finance. B-shares were designed for purchase and trading by foreign investors and are traded in US\$ in Shanghai and in HK\$ in Shenzhen. Companies issuing B-shares have additionally prepared financial reports in accordance with the International Financial Reporting Standards (IFRSs) and International Accounting Standards (IASs) as the quality of China's domestic financial statements was thought to be insufficient for international users (Ball *et al.*, 2000). H-shares are shares of mainland registered state-owned companies or companies listed on the Hong Kong Stock Exchange. Companies issuing H-shares have been required to follow either the IFRSs/IASs or Hong Kong accounting standards.

From research, it appears that specific features of the Chinese financial market for tradable shares may be summarised as follows: multiple classes of equity and market segmentation; central planning for stock market listing; high volatility; little co-movement with other markets; markets with asymmetric information; uneven investor structure; and the B-Share discount (Branson and Sun, 1999). High volatility is also reflected by the observation that individual investors were clearly dominant in the domestic Chinese market, consistent with the number of investor accounts opened by the end of 2002. However, with the introduction of policy supported by government, the proportion of sophisticated investors, and institutional investors such as fund management firms, insurance companies, QFII and other general institutional investors, in particular, exhibits a steady increasing trend. At the end of 2007, institutional investors held about 48.8 per cent of total market capitalisation (CSRC, 2008).

The main role of financial intermediaries is in effect to speed up information flows and reduce information asymmetry in the financial market. To encourage a positive contribution and influence of analysts in the Chinese securities market, the Securities Analysts Association of China (SAAC) was officially established in Beijing in June 2000, marking a milestone in the development of China's securities analysis services. It was believed that the SAAC would direct the healthy development of the securities

investment consultation industry and help promote rational investment in China's securities market (Asian Securities Analysts Federation, 2004, pp. 27-30). There are theoretical reasons as to why the Chinese-specific context may weaken financial analysts' incentives to actively search for information. Heilmann (2002) concluded that a tiny flaw in regulations might much more seriously impact the financial market than in the case of common product markets. For investors, Chan *et al.* (2008) hold that obtaining information on Chinese companies is costly, especially given information asymmetry in the Chinese context. Chan *et al.* (2008) also concluded that the behaviour of active investors may to some extent be "copied" by the non-active. This weakens the incentive for information searches. Concurrently, listed companies tend to offer as little information as possible. Thus, the information monopoly increases investors' information search costs (Chan *et al.*, 2008). Research also suggests that the behaviour of Chinese analysts does not satisfy investors due to ethical issues (Jin and Cai, 2003).

4. Information usage and appraisal techniques used by financial analysts

Previous studies suggest that socio-economic and country-specific factors help explain differences in the perceived level of importance of certain information resources and appraisal techniques and in the approach adopted by financial analysts in appraising ordinary shares (e.g. Pike *et al.*, 1993; Moyes *et al.*, 1997, 2001). The empirical evidence, over time and across countries, suggests that fundamental analysis is the most useful appraisal technique to financial analysts. This result holds over time and across a number of countries. Compared with fundamental analysis, technical analysis is consistently shown to be of relatively minor importance, even where β analysis is distinguished as a relatively sophisticated sub-category of fundamental analysis and analysed separately (e.g. Arnold and Moizer, 1984).

Analysts use valuation models in assessing share prices. According to previous research, some of the most consistent findings are that the price to earnings (P/E) ratio is of primary importance and that the discounted cash flow model is of little practical importance to investment decisions (e.g. Arnold and Moizer, 1984; Moizer and Arnold, 1984; Pike *et al.*, 1993; Barker, 1999b; Block, 1999). A more recent UK study indicates that discounted cash flow method has become significantly more important in analyst perception than prior survey evidences, suggesting that analysts' preferences have changed over the years (Imam *et al.*, 2008). Further, market participants place heavy reliance upon the dividend yield rather than the dividend discount model as a basis for valuing shares (e.g. Arnold and Moizer, 1984; Pike *et al.*, 1993; Barker, 1999a). Accounting information, especially the annual report, and direct contact with company management, represents the most important and useful information sources to financial analysts. In studies concerning the UK, however, there is a clear shift in the relative importance of these sources over time, towards more direct contact with company management (Barker, 1999b; Clatworthy, 2002). There are several studies undertaken in China at the aggregate level to investigate value-relevance of Chinese GAAP-based statement versus those based on international standards (e.g. Bao and Chow, 1999; Chen *et al.*, 1999). Results indicate that information based on Chinese GAAP is value relevant but Chinese GAAP is less conservative than international standards. Chen *et al.* (1999) also confirm that the level of disclosure for the B-share is much higher than in A-share reports. According to Bao and Chow (1999), the earnings and book values reported based on international standards have greater information content than those based on Chinese GAAP. Companies increase information

disclosure voluntarily in reconciliation of their annual reports according to the IFRSs in order to enhance their reputation and credibility (Liu and Eddie, 2007). Their findings also suggested that the differences between the two sets of earnings were engendered by differences in accounting standards and financial rules, opportunistic applications of Chinese GAAP and unusual market-wide events. Chen *et al.* (2002a) found that A-share investors appeared to place most weight on earnings calculated according to domestic accounting standards, only recently paying more attention to results based on the international standards. The sensitivity test showed that accounting information was more likely to be impounded in share prices and returns for those firms with a high percentage of tradable shares in their share capital.

5. Research methods

The research method chosen for this project was a questionnaire survey[5] to be completed by financial analysts. Survey-based research studies rely upon direct contact with financial analysts and thus have considerable potential to provide insights into analysts' valuation behaviour including their preferences for different sources of information and valuation techniques and models. The small sample sizes in research on particular countries or regions tend to reflect the development stage of the financial analysis industry in those areas. The average response rate from financial analysts in questionnaire surveys across all countries is 40 per cent, indicating a relatively high level of co-operation in contrast to general opinion surveys (see Moyes *et al.*, 1997; Tijjani *et al.*, 2009).

In the Chinese context there were problems associated with identifying the target population and administering the questionnaire. Sample selection here focuses on analysts working in financial institutions, such as securities companies, fund management firms and investment consultancy firms. Within securities companies, financial analysts, especially those who work in the research departments, are identified as the most appropriate research subjects by job description. The total number of fund management firms in China by the end of 2001 was 14 compared with 101 securities companies (CSRC, 2002), noting that both securities companies and fund management firms in China are government owned. By the end of 2000, about 50 investment consultancy firms were registered with the SAAC. The sample of securities companies for the current study was selected from a List of the Top 50 securities in terms of trading value (Shanghai Stock Exchange, 2002, pp. 128-30).

Sample selection of financial analysts here was a strategic process. Given the cultural and political context, it was practically infeasible to get postal replies. A cultural feature of significance is *guan xi* (connections). It is universal to build up a social network in a person's life and career, and yet the form and purposes of this may differ between different cultures. In China, personal relationships or social networks may help people obtain privileges, tackle difficult situations and access valuable resources, including information resources. Initially, firms were selected consistent with stratified sampling on the basis of their representativeness as key firms and were pursued through personal contact. *Guan xi* here not only secured several responses but also likely improved response quality as reluctance to cooperate was significantly reduced. Given the context, personal contacts were the only feasible way of accessing a reasonable sample.

The questionnaire was designed with reference to previous research into information usage and appraisal techniques in analysing shares in the UK context (e.g. Arnold and Moizer, 1984; Barker, 1998; Clatworthy, 2002), but with appropriate modification for the

specific Chinese context. During the questionnaire design stage, the required format and outline for the annual reports was reviewed on Chinese government web sites along with prior research into corporate disclosures in China (Xiao, 1999).

A total of 145 questionnaires were sent out, and 65 survey responses were received between March and October 2003 and are used in current study. The response rate for the entire survey, using *guan xi*, was approximately 46 per cent, which is higher than the typical response rate (around 40 per cent) in prior research studies. The reasons given for non-completion included: no time/too busy, company policy, no apparent benefit to participants.

6. Results and discussion

Table I presents the demographic information on the research participants in respect to gender, working experience, education and professional qualification obtained. Two-thirds of the respondents were male and almost half of the respondents had four or more years' experience working as financial analysts. All research respondents possessed a formal undergraduate qualification and more than half of the participants had a postgraduate qualification, a result is consistent with the respondent profile of at least one other study (see Hu *et al.*, 2003a). The four top-ranked qualifications possessed by responding analysts were all based on examinations organised by the SAAC[6], which covered four specialisms – securities broking, securities issuing and selling by contract, investment analysis and fund management. Of respondents 65 per cent had the securities investment analysis and 59 per cent the securities broking qualification. Only one of the analysts had an international qualification, being a Chartered Financial Analyst.

Services provided and types of shares valued by the analysts

Respondents were asked to identify the services they provided. Table II shows that the majority of respondents (72 per cent) made investment recommendations. A minority

	Percentage
<i>Gender</i>	
Male	66.7
Female	33.3
<i>Experience as financial analysts</i>	
1-4 years	51
Above 4 years	49
<i>Educational background</i>	
Undergraduate	45.6
Postgraduate	54.4
<i>Professional qualifications^a</i>	
Securities investment analysis (SAAC)	65
Securities broking (SAAC)	58
Securities issuing and selling (SAAC)	55
Fund management (SAAC)	12
China CPA	6
Chartered financial analyst	2

Table I.
Information on financial
analysts

Note: ^aPercentage of respondents

provided informed views on events (40 per cent) with all other types of services being provided less often.

As the Chinese stock market is segmented into different categories of tradable shares, respondents were asked to specify the types they analysed. The valuation of A-shares was the service most often identified by analysts (96 per cent). As the A-share market is the largest by market value, this is not surprising. Only 31 per cent were involved in valuing B-shares, with only 9 per cent analysing H-shares.

Usefulness of information sources to analysts in an environment of costly information

Table III presents the overall results of the survey on the usefulness of information sources to analysts. Analysts were required to rate each of the sources listed in Table III on a five-point scale, where 1 represented “not at all useful” and 5 represented “extremely useful”. Information sources were subdivided into three groups: financial information; quantified non-financial information and non-quantified information. Kendall’s coefficient of concordance (W) was computed to determine the agreement among analysts in ranking the usefulness of information sources. The level of agreement among the 49 analysts [7] in ranking the usefulness of information sources was a highly significant at 36.7 per cent. Kendall’s mean scores show the sum of the ordinal ranking on the usefulness of each source of information assigned by each analyst. The highest ranking from this data indicates that the annual report was the most important information source of information for financial analysts, a finding supported by prior aggregate level studies (Chen *et al.*, 2002a, b).

The second and third-ranked information sources were industry statistics and firm-specific stock market data, respectively. Industry statistics normally provided analysts with the overall performance of a specific industry and firm-specific stock market data showed how the share was performing in the secondary market. The fourth- and fifth-ranked information sources were company visits and meetings with company management. “Guan xi” (connections) is largely used at this stage in providing opportunities to get access and acquire company information. This result indicates that actively seeking information by Chinese financial analysts perceived that actively seeking information that is not found in the accounting reports added meaning in investment analysis. Wilcoxon tests shown in Table III are tests of the significance of the difference between a given ranked source of information and the next ranked source of information. Four out of 15 of these tests are significant at the 5 per cent level. For example, the top-ranked category is significantly different at the 0.2 per cent level from the second ranked; “other financial analysts’ forecasts’ were deemed significantly

Service to clients	Services	No. of respondents	%
	Making investment recommendations	47	73
	Providing informed views on events	26	40
	Assessing the economic performance of individual firms	22	34
	Assessing the economic performance of an industry/industries	14	22
	Providing technical assistance in financial management	5	8
	Others	6	9
Type of share	A	63	
Valued by	B	20	
Analysts	H	6	

Table II.
Service to clients and type
of share valued by
analysts

Sources of information	Significance of differences between ranks: Wilcoxon test probability	Mean rank	Mean* (1-5)	Mode (1-5)	Standard deviation	Median (1-5)
The annual report and accounts	0.002*	12.33	3.91	4	0.90	3
Industry statistics	0.292	11.52	3.49	4	1.02	4
Firm-specific stock market data	0.361	11.01	3.66	4	0.84	3
Company visit	0.569	10.76	3.49	4	1.21	3
Meeting with company management	0.567	10.73	3.44	4	1.19	3
Interim financial statement	0.409	10.10	3.54	4	0.94	3
Generic stock market data	0.166	9.76	3.42	3	0.96	4
Auditor statements	0.545	8.70	3.22	3	1.05	3
Official economic statistics	0.835	8.47	3.06	3	1.01	3
Company presentation	0.049*	8.42	3.08	3	0.91	2
Analysts' meeting	0.444	7.51	2.85	3	0.87	3
Independent credit assessment	0.219	6.91	2.79	3	1.00	2
Demand and employment statistics	0.130	6.81	2.61	2	1.11	1
Other financial analysts' forecasts	0.000*	5.79	2.39	2	0.88	2
Newspaper and journal report	0.013*	4.01	1.97	2	0.82	2
Analysis report on the web	–	3.21	1.78	2	0.63	2

Table III.
Information sources used
by financial analysts

Notes: *Significant at the 0.05 level; Kendall's coefficient of concordance: $W = 0.367$, Significance = 0.000. Sample size = 49. Key: 1 = not at all useful, 2 = not very useful, 3 = quite useful, 4 = very useful, 5 = extremely useful

less useful than “demand and employment statistics”. Furthermore, analysts do not appear to focus much on publicly available information provided by newspapers and journals, or on the web.

UK studies have reported that in more recent times what is perceived as most important as an information source has shifted from the annual report to company visits and meetings with company management, which allow face-to-face interaction between a company and analysts. Such interaction enables analysts to obtain valuable insights about the calibre of the management team and their strategy for the future. In the UK setting it is argued that analysts might be concerned about insider information allegations (Moizer and Arnold, 1984), although this does not seem to have prevented company visits from occurring and becoming more important. The other possible reason for this shift towards greater reliance on personal contact with companies may be a response by analysts to the allegation that there was a lack of communication between institutional investors and company management (Pike *et al.*, 1993). In contrast, according to the current survey questionnaire, Chinese financial analysts considered annual reports and accounts as the most important information source, with company visits and meetings with management being ranked fourth and fifth. Possible reasons for the differences between the importance of sources of information perceived by UK and Chinese analysts include the different role and status of financial intermediaries and the different investment environment. There are star Chinese

analysts in the Chinese financial market whose recommendations may influence (especially individual) investor behaviour, and thus the non-star analysts may have seen little point in attending meetings.

Appraisal and analysis techniques

According to Branson and Sun (1999), because of heavy-handed government intervention and the speculative behaviour of Chinese investors, high volatility is a characteristic of Chinese equity markets, which signals that technical analysis may be highly regarded in the Chinese investing community. Based on current survey (Table IV), 80 per cent of respondents viewed fundamental analysis[8] as a very useful or extremely useful appraisal technique with an overall mean of 4.11 out of a maximum 5.00, whereas the corresponding percentage for technical analysis was only 44 per cent. Financial analysts' opinions concerning the usefulness of fundamental analysis were significantly higher than technical analysis as indicated by the Wilcoxon test result.

Previous research has shown that technical analysis in China had greater significance and weight than fundamental analysis (Zhu and Wang, 2001). Even with the development of institutional investors in recent years, particularly the fund management firms, however, fundamental analysis has become the dominant appraisal technique according to the results of the current survey. Previous research has also indicated that fundamental analysis was the most frequently used technique in the UK (e.g. Barker, 1998; Clatworthy, 2002). Although Chinese analysts have been starting to focus more on companies' fundamentals than firm-specific stock market data, notions of "intrinsic value" have engendered slightly different procedures from those adopted by UK counterparts due to highly asymmetric information in the Chinese stock market.

Usefulness of various appraisal methods in fundamental analysis

Within the context of fundamental analysis, several different techniques may be used. Previous UK studies have differed from each other in terms of the appraisal techniques considered. The list of appraisal techniques used in this study is similar to that used by Pike *et al.* (1993) but with "financial statement analysis" added. Table V shows the top two useful methods are financial statement analysis and ratio analysis[9]: 63 per cent of respondents viewing financial statement analysis as either "extremely useful" or "very useful" and 52 per cent having these views in relation to ratio analysis. These two appraisal methods were adopted for predicting earnings in the following year, and allowing for calculation of P/E ratios.

β analysis and the dividend discount model were little used with 41 and 44 per cent of financial analysts viewing both techniques as either "not at all useful" or "not very

	1	2	3	4	5	Mean (1-5)	<i>n</i>	Standard deviation	Wilcoxon test probability
Fundamental analysis	1	1	11	29	23	4.11	65	0.85	0.000
Technical analysis	0	7	29	21	8	3.46	65	0.85	–

Table IV.
Comparison between
fundamental analysis and
technical analysis

Note: Key: See Table III

useful". The low importance of the dividend discount model might be explained by there being (as at 2001) 1,173 companies listed on the stock market, 61 per cent of these paying out cash dividends to shareholders, but the average dividend per share paid out being only RMB 0.08 (Zhang, 2002). In contrast, dividend discount model was considered to be the most important appraisal technique in Pike *et al.*'s (1993) study, however, is reported as having decreased over time (Barker, 1998). The dividend discount model is considered by Chinese analysts to be not particularly useful, especially for A-share companies due to the low dividend payment. Financial statement analysis (not surveyed in prior studies as it was here) and ratio analysis are perceived to be very useful fundamental analysis techniques in China. Clatworthy (2002) also found ratio analysis to be important, whereas Pike *et al.*'s (1993) earlier study ranked it in third place.

Accounting information in the decision-making process: the use of annual reports

The annual report is the main vehicle for corporate reporting and provides both corporate financial and non-financial information to analysts. The content was divided into seven subgroups: brief introduction of the company; three-year summary of operations data; chairman's statement; directors' report; financial statements; and statement of material events. The results (Table VI) show that a clear emphasis was placed on reporting material events [10]. Approximately 86 per cent of analysts rate this item either as "very useful" or "extremely useful".

In China, there is an increasing tendency for information disclosure requirements in respect to material events, especially on matters such as related transactions disclosure (Lee and Zhang, 2000). Such information is arguably crucial for assessing company profit and future expectations. Therefore, financial analysts are apparently processing this kind of information and reducing the information asymmetry between investors and companies.

Of the top ten-ranked items, apart from the statement of material events, all the other components were from the three-year summary of operations data and financial statements. The second-ranked component in the annual report was the earnings to net assets ratio. The cash flow statement was considered the most useful of the financial statements, followed by the income statement and balance sheet. A possible explanation for this is that information on cash flow is useful in interpreting earnings and assessing a company's viability and is further related to firm profitability. Another result worthy of specific mention was the relative usefulness of the notes to the accounts. The results indicate that analysts did not pay much attention to these notes, possibly indicating a lack of in-depth analysis of financial statements.

	Mean rank	Mean (1-5)	Mode (1-5)	Standard deviation	Median (1-5)
Financial statement analysis	4.00	3.82	4	0.85	3
Ratio analysis	3.50	3.57	4	0.81	3
Discounted cash flow model	3.14	3.20	3	1.03	3
β analysis	2.24	2.66	3	0.96	2
Dividend discount model	2.12	2.56	3	0.99	2

Table V.

Appraisal methods used by analysts

Notes: Kendall's coefficient of concordance: $W = 0.384$, significance = 0.000. Sample size = 65. Key: See Table III

	Mean rank	Mean (1-5)	Mode (1-5)	Standard deviation	Median (1-5)
Statement of material events	16.41	4.15	4	0.70	4
Ratio of earnings to net assets	15.86	4.05	4	0.77	3
Cash flow statement	15.39	3.95	4	0.89	4
The income statement	14.66	3.92	4	0.81	3
The balance sheet	14.46	3.90	4	0.73	3
Net operating revenues	13.63	3.78	4	0.77	4
Profit after tax	13.33	3.75	4	0.88	3
Comparative figures for the previous period	13.17	3.71	4	0.80	4
Earnings per share	13.11	3.78	4	0.79	3
Notes to the accounts	13.09	3.73	4	0.89	2
Market share for each type of product	12.88	3.67	4	0.90	4
Description of main businesses	12.67	3.67	4	0.86	4
The statement of changes in equity	12.16	3.67	4	0.84	3
Ownership structure (percentage owned by shareholders)	11.75	3.63	4	0.85	3
Features and scale of operations	11.60	3.58	4	0.91	4
The auditor's report	10.94	3.47	4	0.80	4
Movement in shares and share capital	10.76	3.51	4	0.98	2
Business in different industries	10.61	3.44	3	0.86	4
Segment statement by lines of business	9.29	3.25	3	0.92	3
Progress achieved in the reporting year	8.82	3.24	3	0.95	2
Overall operations objectives and measures to be taken to achieve the objectives	8.29	3.13	3	0.91	2
History and developments	6.72	2.95	3	0.92	2
Details of the management	6.41	2.84	3	0.99	3

Notes: Kendall's coefficient of concordance: $W = 0.234$, significance = 0.000. Sample size = 57

Table VI.
Use of annual reports

The position of the auditor's report is also noteworthy. The auditor's report was given a relatively low ranking. One possible explanation could be that because of the importance attached to company visits and meetings with company management, the nature of the audit report (e.g. whether it is or is not an unqualified opinion) might in substance be anticipated already through those earlier discussions. Another explanation could be that analysts have doubts about auditor ethics and do not think that audit reports add value. This finding is agreed by one article indicating that auditor opinions have currently little "information content" to financial statement users in China (Lin *et al.*, 2003). However, it contradicts other research from the same period that indicates auditors' opinions having relatively strong influence on Chinese analysts' qualitative report conclusions (Hu and Lin, 2008).

Of the 23 components listed, details of the management are ranked the least important item within the annual report. Other general information regarding company operations was also relatively unimportant. Possible explanations may be that analysts perceived that the management section contained in the annual reports did not really reflect the company's real situation or that company visits were a better way to obtain this type of information. This suggests a general point, that the perceived importance of items in the annual report is partly related to the availability of other information including what many have garnered from the company visit and its perceived importance.

Overall, financial accounting information was considered much more important than narrative sections of the annual report, such as management information. The result also suggests that analysts focused on accounting information, especially cash flow-related information, rather than other quantitative or qualitative information. These findings are consistent with the results of the survey by Hu *et al.* (2003).

Usefulness of components in the balance sheet and income statement

The usefulness of a list of 20 balance sheet items is presented in Table VII. Analysts were concerned about the availability of cash to the company in the near future after taking account of immediate financial commitments. Respondents rated debtors, short-term bank loans and cash and bank balance as the three most useful items. The top five components are all relevant to company's working capital, liquidity and solvency position. The lowest rated item was property, plant and equipment. The median score for six items was "very useful" and for the remaining 14 items it was "quite useful" indicating only a modest variation in the perceived importance of the various items for the respondents in total. Overall, information on current assets and liabilities were more important than that pertaining to non-current assets. This result suggests Chinese financial analysts focus on company short-term value rather than its longer-term prospect.

The analysts were presented with a list of nine components of the income statement to rate as to usefulness. The division between revenues from major activities and other activities was viewed as the most important item. It may be because the major activities determined the sustainability and profitability of the company's on-going

	Mean rank	Mean (1-5)	Mode (1-5)	Standard deviation	Median (1-5)
Debtors	14.40	3.95	4	0.84	4
Short-term bank loans	12.27	3.62	3	0.93	3
Cash and bank balance	12.11	3.61	4	0.89	4
Inventories	11.98	3.63	4	0.91	3
Creditors	11.78	3.57	4	0.86	3
Other receivables and prepayments	11.58	3.50	4	0.82	4
Long-term bank loans	11.36	3.52	4	0.93	3
Marketable securities	11.11	3.40	4	0.97	4
Corporate bonds or debentures	10.78	3.44	3	0.93	3
Share capital	10.59	3.42	3	0.93	3
Taxation	10.15	3.41	3	0.89	3
Investments in associates	10.10	3.26	3	0.92	4
Share premium and surplus reserve	10.08	3.33	3	0.87	3
Bonds investments due within a year	9.75	3.29	3	0.88	3
Intangible assets	9.70	3.27	3	0.91	4
Other payables and accrued expenses	9.45	3.27	3	0.91	3
Bonds investment due after 1 year	8.50	3.15	3	0.81	3
Statutory public welfare fund	8.27	3.17	3	0.90	3
Minority interest	8.13	2.95	3	0.85	3
Property, plant and equipment	7.90	3.03	3	1.00	3

Table VII.
Usefulness of components
in the balance sheet

Notes: Kendall's coefficient of concordance: $W = 0.122$, significance = 0.000. Sample size = 51

business. Generally speaking, analysts viewed all items in the income statement to be “very useful”, with all items having the same median score.

Changes in financial analysis and on harmonisation of accounting standards

In order to obtain financial analysts’ opinions in relation to investment analysis and accounting standards in China, both multiple response and open questions were used in the survey. Forty per cent of research respondents mentioned that fundamental analysis was becoming increasingly important. In comparison, the benefits of technical analysis were reducing along with enhanced Chinese financial market efficiency. The use of quantitative relative to qualitative analysis in appraisal was increasing alongside the growth of investor investment knowledge. Despite the reported shortcoming of the Chinese financial market, such as policy-driven market, analysts perceived that investment analysis in China was changing towards more diversification and specialisation, professionalisation and internationalisation.

Analysts were asked whether they viewed the adoption of IAS/IFRS to be useful. The analysts viewed adoption of these standards by A-share companies to be quite useful with a mean of 3.35 and a mode of four on a ranking scale of 1-5.

Prior research indicates a considerable gap between international standards and Chinese GAAP (Chen *et al.*, 1999; Chen *et al.*, 2002b). It was therefore considered useful to explore the perceived reasons for the gap. Analysts were presented with a list of six factors that might explain the gap at the time of the survey[11]. The most important factor identified was differences in institutional infrastructure (83 per cent of respondents), which is also suggested as a factor in prior research (Chen *et al.*, 2002b). Socio-economic characteristics (60 per cent) and legal requirements (54 per cent) were the next most important factors. Less important were the political system (42 per cent), quality of auditing (35 per cent) and lastly the effects of culture, these being viewed as relevant by only 32 per cent of the analysts.

7. Summary, limitations and future research

This paper provides insights into the usage of information sources and appraisal techniques in by financial analysts in appraising ordinary shares. On one hand, as the literature suggested, policy-driven characteristic of Chinese stock market weaken the information search and lack of transparency in the stock market adds more cost to information acquisition. On the other, because of the policy of encouraging development of institutional investor to stabilise the market, there is a strong incentive to mine and process information for meeting demands of more sophisticated investors. This survey indicated that Chinese financial analysts actively searched for information through publically available channels and via private investigation. The most important information source in investment analysis was accounting information. From the Chinese analysts’ points of view, publicly available information regarding company financial position, industry information and firm-specific stock market data already indicated company general profitability; whereas follow-up company visits and meetings with company management may provide additional insights into companies’ future prospects. In contrast, other publicly available information including journal and newspaper reports and analysis reports on the web were ignored by analysts.

The results also show that analysts typically preferred fundamental analysis over technical analysis. This survey evidences a clear shift from technical to fundamental

analysis and a focus on the company as a major information source, consistent with research indicating increasing Chinese market efficiency (Groenewold *et al.*, 2003). In respect to fundamental analysis, ratio analysis and financial statement analysis were highly rated.

The role of the annual report was investigated in greater depth and the findings indicated that financial statements are quite influential information sources. Material statements of events were weighted as the most important section in the annual report since that information could have a substantial influence on company share price. The cash flow statement was rated as the most important statement in comparison with the balance sheet and income statement. Analysts focused more on standard earnings, viability and profitability information about the listed companies than on narrative sections of annual reports. Further investigation of the balance sheet indicated financial analysts pay more attention to a company's short-term working capital and liquidity than they do to long-term prospects.

Cultural influences may have had an effect on survey responses, especially conservatism since analysts tended to avoid the extreme high and low ratings.

Reflecting on our findings, even from this highly focused study we may begin to draw out some more general theoretical insights. The analysts clearly understand fundamental analysis to be important and accounting information to be significant and believe the quality of latter could be improved, including by adoption of international standards (at least for companies with A-shares). Institutional infrastructure and socio-economic characteristics were acknowledged as key forces differentiating China's situation *vis-à-vis* accounting provision from other contexts pointing more generally to the contextual variation in markets and conventions in financial accounting (and related information) analysis, as well as the attendant regulations. While some analysts in effect emphasised the desirability of universal principles driven by substantively Anglo-American conceptions, others gave more weight to the need to relate to the specifics of the Chinese context.

To promote better investment practice, Chinese regulators can consider findings of the current study in reviewing laws and training programme. Investors, any users of financial analyst reports, will be better informed by the findings in terms of understanding the thinking behind analysts' decisions.

Limitations

Because of the specific Chinese context, the sample size for the survey was relatively small, which reduces generalisability in statistical terms. Because of the difference in the number of responses received from analysts and fund managers, comparison between these two groups was not feasible.

Future research

This project resulted in the identification of many additional areas to explore in future studies. One concerns the need to provide insights into how the institutional characteristics of Chinese securities companies' may impact on the performance of their analysts. Follow-up case studies could provide more insights into the decision-making processes of the analysts. Exploring the effects of government policy on the investment analysis practice of Chinese domestic institutional investors would

clearly be worthwhile. Additionally, it would also be interesting to look at the differences in investment analysis practice between different types of institutional investor in China (e.g. state and non-state institutional investors). Study was conducted in 2003; subsequent study would add value to knowledge by identifying trends or changes in analyst practice in relation to changes in the Chinese economy and accounting practices.

Notes

1. For Song (2002), there are differences between domestic and non-domestic markets that mainly arise because of different market regulations, which engender differences in accounting standards, auditing processes and disclosure rules.
2. Hu *et al.* (2003a) focuses on a period just before the period focused upon here.
3. Two related studies (focus on the same period as Hu *et al.*, 2003a) give little attention to information sources and usage but give insights into information comprehension and analyst ability (see Hu *et al.*, 2003b; Hu *et al.*, 2008). Results of these studies point to the benefits to analysts of company level surveys and indirect information sources on information comprehension and analyst ability. At the same time, they conclude that financial analysts are still a fledgling profession in China.
4. Government shares include two kinds of state-owned assets: one is financed and managed by the central government institutes and bureaux and the other is financed and managed by local governments (CSRC, 2002). Legal persons are defined as collective organisations considered by the law as having a legal personality distinct from the natural individuals who make them up.
5. A copy of the questionnaire is available from the corresponding author.
6. According to the Chinese regulation on “Qualification Governance for Employees in the Securities Market” (CSRC, 2003), persons wishing to work in financial services needed to take one foundation and one specialised examination to obtain an employment qualification. For employment in financial consultancy, there were two additional requirements, including an undergraduate or higher level degree and two years work experience in the financial market (CSRC, 1998).
7. Respondents who did not answer all questions had to be omitted.
8. Fundamental analysis relies on using accounting, industry and economic information in developing an analysis of the company’s equity. Technical analysis involves analysis of past share price movements to identify trends or patterns to predict future share prices (Arnold and Moizer, 1984).
9. “Financial statement analysis” is defined in the questionnaire as “starting with an overview of the company, then reviewing accounting statements”. “Ratio analysis” is defined as “to compare and interpret the values of various financial statement items”.
10. Material events referred to events that if known could have a significant influence on the company’s share price, including the disposal of assets and acquisitions, related business disclosure, major contracts and changing the company’s auditor and other legal proceedings (CSRC, 1998, 1999).
11. China has subsequently moved its accounting standards much nearer to international standards. The Ministry of Finance decided that Chinese Accounting Standards will converge with IFRS from January 2007 (Ding and Su, 2008).

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THE QUESTIONNAIRE

Section 1: General Information

23

1. What kind of organisation are you employed by? (please tick).

Investment consultancy	[]
Securities firm	[]
Unit Trust	[]
Investment Trust	[]
Insurance company	[]
Industrial company	[]
Pension fund	[]
Other (please specify)	[]

2. What kinds of services are you providing to your clients? (Please tick one or more brackets).

Making investment recommendations	[] 1
Assessing the economic performance of individual firms	[] 2
Assessing the economic performance of an industry/ industries	[] 3
Providing technical assistance in financial management	[] 4
Providing informed views on events	[] 5
Other (please specify)	[] 6

3. Which kind of shares are you evaluating? (please tick one or more brackets).

A Shares	[] 1
B Shares	[] 2
H Shares	[] 3

(continued)

Figure A1.

Section 2: Information Sources for Analysts

4. How useful are the following information sources to you in evaluating a company's equity?

	not at all useful 1	not very useful 2	quite useful 3	very useful 4	extremely useful 5
Financial Information					
The annual report and accounts					
Interim financial statement					
Firm-specific stock market data					
Generic stock market data					
Financial analysts' forecasts					
Quantified Non-financial Information					
Official economic statistics					
Demand and employment statistics					
Industry statistics					
Non-quantified Information					
Auditor's statements					
Independent credit assessment					
Company visit					
Meeting with company management					
Analysts' meeting					
Company presentation					
Newspaper and journal report					
Analysis report on the Web-site					
Others (please specify)					

Figure A1.

(continued)

Section 3: Appraisal Techniques/ Analysis Techniques

5. How useful are the following appraisal techniques to you when evaluating the securities of the companies?

	not at all useful 1	not very useful 2	quite useful 3	very useful 4	extremely useful 5
Fundamental analysis Using accounting, industry and economic information in developing an analysis of the company's equity.					
Technical analysis Looking for and using patterns in the movement of the share price.					

6. In relation to fundamental analysis, do you use any of the following approaches? And how useful are they?

	not at all useful 1	not very useful 2	quite useful 3	very useful 4	extremely useful 5
Financial statement analysis Starting with an overview of the company, then reviewing accounting statements.					
Ratio analysis This is a way to compare and interpret the values of various financial statement items. For instance, the profitability ratio is profit over sales.					
Discounted cash flow model This is to make an estimation of share price by discounting the future cash flows associated with securities.					
Beta analysis Making use of the beta factor in a capital asset pricing model, where beta is taken to be an estimate that relates the return on the specific asset to the return on a market portfolio.					
Dividend Discount Model This model is used to estimate share price by the discounting of future dividends.					
Other (please specify)					

Please elaborate or comment on your answers:

* This question arguably should have been broken into two. Nevertheless, the interpretation was that someone who did not use the approach would either not complete this section or tick 1 (not at all useful).

(continued)

Figure A1.

Section 4: Use of Annual Reports

7. If you use annual reports when appraising securities, please indicate how useful the following items are.

	not at all useful 1	not very useful 2	quite useful 3	very useful 4	extremely useful 5
Brief introduction of the company					
History and developments					
Main businesses					
Features and scale of operations					
Three-year summary of operations data					
Net operating revenues					
Profit after tax					
Earnings per share					
Ratio of earnings to net assets					
Chairman's statement					
Progress achieved in the reporting year					
Market share of each type of product					
Business in different industries					
Overall operations objectives and measures to be taken to achieve the objectives					
Director's report					
Movement in shares and share capital					
Ownership structure (percentage owned by shareholders)					
The management					
Financial Statements					
The balance sheet					
The income statement					
The statement of changes in equity					
Segment statement by lines of business					
Cash flow statement					
Notes to the accounts					
Comparative figures for the previous period					
The auditor's report					
Statement of material events					
Other Information (please specify)					

Figure A1.

(continued)

8. When you are looking at the Balance Sheet, do you look at these items? And how useful do you think they are?

	not at all useful 1	not very useful 2	quite useful 3	very useful 4	extremely useful 5
Assets					
Non-current assets					
Intangible assets					
Property, plant and equipment					
Bonds investment after one year					
Investments in associates					
Other non-current assets (please specify)					
Current assets					
Inventories					
Debtors					
Marketable securities					
Bonds investments due within a year					
Other receivables and prepayments					
Cash and bank balance					
Other current assets (please specify)					
Equity and Liabilities					
Capital and reserves					
Share capital					
Share premium and surplus reserve					
Statutory public welfare fund					
Minority interests					
Other capital and reserves (please specify)					
Non-current liabilities					
Long-term bank loans					
Corporate bonds or debentures					
Other non-current liabilities (please specify)					
Current liabilities					
Creditors					
Other payables and accrued expenses					
Short-term bank loans					
Taxation					
Other current liabilities (please specify)					

(continued)

Figure A1.

9. When you look at the Income Statement, how useful are the following items?*

	not at all useful 1	not very useful 2	Quite useful 3	very useful 4	Extremely useful 5
Sales					
Breakdown of revenues from major activities and non-major activities					
Cost of sales					
Gross profit					
Selling expenses					
Administrative expenses					
Financial expenses					
Taxation					
Earnings per share					
Others (please specify)					

Figure A1.

* Items in Question 9 correspond more to Chinese accounting format.

(continued)

Section 5

10. Please give me your opinions about what changes in financial analysis in China are underway. And what issues are arising?

11. On the scale of 1 to 5, where 1=nearly not at all and 5=very much, to what extent would you think the adoption of International Accounting Standard (IAS/IFPS) will be useful for A-share investors. (Please circle).

1 2 3 4 5

12. According to prior research, There is a gap between IAS/IFPS and Chinese GAAP. What reasons do you think might cause this situation? (please tick all applicable boxes).

- | | | |
|---|--------------------------|---|
| Differences in institutional infrastructure | <input type="checkbox"/> | 1 |
| Culture | <input type="checkbox"/> | 2 |
| Legal requirements | <input type="checkbox"/> | 3 |
| Socioeconomic factors | <input type="checkbox"/> | 4 |
| Political system | <input type="checkbox"/> | 5 |
| Quality of auditing | <input type="checkbox"/> | 6 |
| Others (please specify) | <input type="checkbox"/> | 7 |

13. Please add any opinion or comments about financial analysis in practice that have not been covered in this questionnaire or any comments you have on the questionnaire.

(continued)

Figure A1.

Section 6: Respondent Details

Thank you for completing this questionnaire. It would be most helpful if you could complete the following section. All the information you provided in this questionnaire will be kept strictly **confidential**.

Your name: _____

Job title: _____

Experience as an analyst: _____ Years

Gender: (please tick) Male [] Female []

Qualification: (Please tick)

Undergraduate Dip/Degree [] Subject: _____

Postgraduate Degree [] Subject: _____

Postgraduate Research Degree [] Research topic _____

Do you have any relevant professional qualification? Yes [] No []

If yes, please specify: _____

Would you like to participate in a follow up interview regarding the issues covered in this questionnaire?

Yes [] No []

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DATE REPLY RECEIVED

REPLY NUMBER

Figure A1.

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