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Circuit courts and capital market transparency: Evidence from analysts' earnings forecasts

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ABSTRACT

This study examines how judicial quality enhancements, such as the establishment of circuit courts, affect analysts' profits projection quality for Chinese A-share listed companies (2010–2021). A staggered difference-in-differences model shows that circuit courts significantly reduce forecast errors and dispersion, improving corporate disclosure transparency and reducing information asymmetry. Heterogeneity analysis reveals that these effects are particularly prominent in large and high-leverage firms. Moreover, the moderating role of internal control, management expenses, and disclosure quality emphasizes the importance of circuit courts in promoting financial transparency. Findings provide guidance for optimizing judicial systems, strengthening governance, and improving disclosure standards.

1. Introduction

The efficient functioning of capital markets depends heavily on high-quality information disclosure, as information asymmetry has long been recognized as a significant barrier to market efficiency (Chen et al., 2011). As key capital market intermediaries, analysts provide investors with evaluations of firms' value and future performance through earnings predictions, directly influencing resource allocation efficiency. However, the accuracy and consistency of analysts' earnings forecasts are not solely determined by corporate information disclosure; they are also affected by the legal climate and external regulatory control. Law and finance research has shown that legal regimes shape capital markets and corporate development (La Porta et al., 1998). Judicial quality is a core component of the legal environment. It constrains corporate behavior, regulates information disclosure, and enhances market transparency.

Analysts use their skills and information to analyze and forecast corporate data, offering investors with earnings predictions and investment advice. This process improves capital market information transmission and resource allocation (Bradley et al., 2017). Existing studies have found factors influencing the quality of analysts' earnings forecasts. Individual attributes, such as analysts' capabilities, resources, and information routes, significantly affect forecast accuracy (Clement, 1999). Moreover, macrolevel factors, including policy reforms such as anticorruption efforts, substantially improve forecast precision (Hou et al., 2022). At the corporate level, financial and nonfinancial variables, including research and development investments, tax behaviors, cost stickiness, and corporate social responsibility shape analysts' forecasts quality (Dhaliwal et al., 2012; Francis et al., 2019; Huang and Zhang, 2011). Although considerable research has examined the impact of judicial quality improvements on corporate innovation, ESG performance,

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and productivity, its relationship with analysts' earnings forecast quality remains underexplored (Chemin, 2020; Lai et al., 2023; Xue and He, 2024).

This study employs a sample of Chinese A-share listed companies on the Shanghai and Shenzhen stock exchanges from 2010 to 2021 to examine the impact of judicial quality improvements, such as circuit courts, on analysts' earnings forecast quality and mechanisms. Additionally, we analyze the heterogeneous effects of firm characteristics. This study contributes to the literature on analyst' forecast quality by emphasizing on judicial quality and stressing the role of external legal environment and internal governance mechanisms in enhancing capital market information efficiency. The findings deepen our understanding of the economic effects of judicial quality improvements and offer policy insights for optimizing the capital market, refining the judicial system, and enhancing corporate information disclosure.

2. Model design and variable selection

2.1. Model design

The implementation of circuit courts occurred gradually, with coverage steadily spreading across provinces. A staggered difference-in-differences (DID) model was used to assess the policy effects of circuit court implementation.

$$FERROR_{i,t}(FDISP_{i,t}) = \beta_0 + \beta_1 Court_{i,t} + \alpha \sum Controls_{i,t} + \sum Year + \sum Firm + \varepsilon_{i,t} \quad (1)$$

In the model, *i* represents firms, and *t* denotes years. The dependent variable, *FERROR (FDISP)*, measures analyst forecast errors and disagreements. The primary independent variable, *Court*, is a binary indicator of the establishment of circuit courts. *Court* equals 1 if the region where the firm is located is covered by a circuit court in a given year or any subsequent year, and 0 otherwise. *Controls* refers to a set of control variables. *Year* denotes year fixed effects (FEs), and *Firm* represents individual (firm) FEs, which account for time- and firm-specific influences, respectively. The error term $\varepsilon_{i,t}$ denotes random disturbances. Clustering occurs at the firm level to address potential heteroskedasticity and autocorrelation concerns over time.

2.2. Variable selection

2.2.1. Dependent variable

Following Demmer et al. (2019) methodology, this study assesses the validity of analysts' earnings estimates using forecast error and forecast dispersion. Forecast errors are smaller and the dispersion is lower, indicating better forecast quality. Forecast error (*FERROR*) is calculated as the mean absolute error between analysts' predicted earnings per share (EPS) and actual EPS. The formula is as follows:

$$FERROR = \frac{Abs(Mean(FEPS) - MEPS)}{Abs(MEPS)} \quad (2)$$

where *Mean(FEPS)* reflects the mean of all analysts' forecasts, and *MEPS* denotes the firm's actual EPS in a given year. To ensure accuracy, forecasts for future years made during the current year are excluded and only the latest forecast for the current year is considered. A larger *FERROR* value suggests lower accuracy and poorer forecast quality.

Forecast dispersion (*FDISP)* is defined as the standard deviation of analysts' EPS projections for a certain firm in a given year. The calculation formula is as follows:

$$FDISP = \frac{Std(FEPS)}{Abs(MEPS)} \quad (3)$$

where *Std(FEPS)* denotes the standard deviation of all analysts' forecasts. A higher *FDISP* value signifies greater disagreement among analysts and lower forecast quality.

2.2.2. Independent variables

This study treats the establishment of circuit courts by China's Supreme People's Court as a quasi-natural experiment. Firms headquartered in circuit court-covered regions are assigned to the treatment group, with a binary variable set to 1, whereas those in uncovered regions are assigned to the control group, with the variable set to 0. A time dummy variable has a value of 1 for years after a circuit court covers a region and 0 otherwise. The interaction term between the group dummy and the time dummy denotes the variable *Court*, which captures the effects of circuit court implementation.

2.2.3. Control variables

The model incorporates several control variables to account for firm-level characteristics. *Firm Size* is measured as the natural logarithm of total assets. *Leverage* is the ratio of total liabilities to total assets, whereas *Return on Assets* is the ratio of net profit to total assets. *Ownership Concentration* represents the ratio of shares the top five shareholders holds to total shares. Meanwhile, *Asset Turnover* is calculated as the ratio of sales revenue to total assets. *Tobin's Q* is defined as the ratio of a firm's market value to its total assets. Lastly, *Cash Flow* is defined as the sum of cash and tradable financial assets as a percentage of total assets.

2.3. Data source

The study uses data from Chinese A-share listed companies from 2010 to 2021 investigates the relationship between judicial quality improvement and analyst forecast quality. The sample was constructed in several steps: financial firms were excluded, firms with abnormal operations (e.g., ST or *ST) were removed, and observations with missing data were discarded. The resulting dataset is an unbalanced panel that contains 28,118 valid observations. Data for the variables were sourced from the CSMAR and Wind databases. Table 1 presents the descriptive statistics for the primary variables, which reveals significant variation across firms in financial structure, profitability, market valuation, and governance characteristics. *FDISP* and *FERROR* exhibit considerable heterogeneity, with mean values of 1.211 and 2.160, respectively, and high standard deviations, indicating diverse forecasting issues. Circuit court coverage (*Court*) applies to ~44.4 % of firms.

3. Results

3.1. Benchmark model testing

Table 2 presents the baseline regression results. Columns (1) and (4) include only FEs, whereas Columns (2) and (5) incorporate control variables and individual FEs. Columns (3) and (6) include all control variables. All parameters include a coefficient for *Court* that is significantly negative at the 5 % level or better, demonstrating that judicial quality improvement, such as circuit courts, reduces analysts' forecast errors and dispersion.

This finding suggests that enhanced judicial quality improves corporate information disclosure transparency and accuracy, lowering information asymmetry and market noise (Lv et al., 2024). Through stronger judicial oversight, circuit courts inhibit corporate misbehavior and encourage more accurate and timely disclosure practices, providing analysts with more reliable data. This method reduces analyst conflicts generated by asymmetric information and enhances earnings forecast accuracy and consistency.

3.2. Endogeneity and robustness tests

3.2.1. PSM-DID

Although the circuit court establishment is an exogenous policy decision, endogeneity may exist between this policy and analysts' earnings forecast errors. Circuit courts are more probable in regions with frequent judicial disputes, inadequate corporate governance, or complicated economic operations. These regions may have increased information asymmetry, resulting in greater forecast errors. Propensity score matching (PSM) and a DID framework are used to solve the endogeneity issue resulting from probable selection bias in pilot regions. To construct propensity scores, we use a logit model with maximum likelihood estimation, covariates such as firm size, asset turnover, leverage, ownership concentration, cash flow, return on assets, and Tobin's Q. A 1:1 matching ratio is applied for validation. Columns (1) and (2) of Table 3 present the PSM-DID regression results.

3.2.2. Group reclassification

To further test robustness, this study ranked analysts' forecast errors in descending order and divided them into three groups. Ignoring the intermediate group leaves only the highest and lowest groupings for analysis. Subsequently, a regression is conducted to assess the impact of circuit court implementation on analysts' forecast errors. Columns (3) and (4) in Table 3 show that circuit court establishment continues to significantly reduce forecast errors at the 1 % significance level, confirming the robustness of the findings.

3.2.3. Replacing FEs models

Regression results in Columns (5) and (6) of Table 3 show that region, industry, and year FEs are included to strengthen the findings' validity. Local institutional characteristics do not complicate circuit courts' estimated impact since regional FEs adjust for differences in law enforcement, economic development, and financial market maturity. Similarly, industry FEs account for sector-specific differences in financial transparency, regulatory oversight, and legal reform sensitivity, preventing distortions in the estimated link between circuit courts and analysts' forecast accuracy. Individual and year FEs provide a solid foundation for the baseline

Table 1
Descriptive statistics.

Variable	N	Mean	SD	Min	P50	Max
FDISP	28,118	1.211	2.695	0	0.381	19.33
FERROR	28,118	2.160	4.755	0	0.615	32.50
Court	28,118	0.444	0.497	0	0	1
Lev	28,118	0.421	0.312	0.008	0.409	31.47
Turnover	28,118	0.628	0.498	0.001	0.522	11.42
Roa	28,118	0.055	0.204	−29.02	0.057	2.646
Tobin's Q	28,118	2.170	11.50	0.641	1.614	1753
Top5 HHI	28,118	0.501	0.195	0.200	0.462	0.994
Cash	28,118	0.211	0.155	0.001	0.166	0.998
Size	28,118	22.27	1.344	13.76	22.07	28.64

Table 2
Results of regression analyses.

Variables	(1) *FDISP*	(2) *FDISP*	(3) *FDISP*	(4) *FERROR*	(5) *FERROR*	(6) *FERROR*
Court	−0.199**	−0.460***	−0.178**	−0.420***	−0.230**	−0.363***
	(−2.52)	(−7.69)	(−2.31)	(−2.97)	(−2.12)	(−2.66)
lev		−0.561***	−0.562***		−1.660***	−1.639***
		(−3.27)	(−3.16)		(−3.73)	(−3.92)
Turnover		−0.851***	−0.841***		−1.624***	−1.695***
		(−7.07)	(−6.98)		(−6.60)	(−6.51)
Roa		−0.727***	−0.751***		−2.367***	−2.206***
		(−3.64)	(−3.57)		(−4.21)	(−4.26)
Tobin's Q		0.005***	0.005***		0.025***	0.025***
		(3.66)	(3.76)		(6.45)	(7.26)
Top5_HHI		1.388***	1.303***		2.161***	2.007***
		(5.81)	(5.48)		(5.10)	(4.77)
Cash		−2.510***	−2.327***		−4.652***	−4.610***
		(−14.61)	(−12.84)		(−14.69)	(−13.93)
Size		0.084*	0.177***		−0.029	−0.239*
		(1.81)	(2.83)		(−0.29)	(−1.87)
Constant	1.313***	0.197	−2.015	2.366***	4.605**	9.442***
	(37.91)	(0.19)	(−1.44)	(38.09)	(2.11)	(3.28)
Year FE	Yes	No	Yes	Yes	No	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	27,747	27,747	27,747	27,747	27,747	27,747
R-squared	0.221	0.229	0.234	0.229	0.239	0.247

Note: Numbers in parentheses represent t-values. *, **, and *** denote significance at the 10 %, 5 %, and 1 % levels, respectively.

Table 3
Results of robustness test.

	(1) PSM-DID	(2)	(3) Group Reclassification	(4)	(5) Replacing Fixed Effects Models	(6)
Variables	*FERROR*	*FDISP*	*FERROR*	*FDISP*	*FERROR*	*FDISP*
Court	−0.618**	−0.287**	−0.522***	−0.242**	−0.368***	−0.195***
	(−2.51)	(−2.03)	(−2.66)	(−2.18)	(−2.80)	(−2.63)
Constant	7.554	−3.688	12.524***	−4.169**	9.775***	2.116***
	(1.28)	(−1.41)	(3.08)	(−2.07)	(12.48)	(4.76)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	No	No
Industry FE	No	No	No	No	Yes	Yes
Regional FE	No	No	No	No	Yes	Yes
Observations	8233	8233	18,224	18,232	28,118	28,118
R-squared	0.336	0.324	0.313	0.313	0.054	0.053

Table 4
Results of heterogeneity analysis.

	(1) Large Scale	(2) Small Scale	(3) Large Scale	(4) Small Scale	(5) High Leverage	(6) Low Leverage	(7) High Leverage	(8) Low Leverage
Variables	*FERROR*	*FERROR*	*FDISP*	*FDISP*	*FERROR*	*FERROR*	*FDISP*	*FDISP*
Court	−0.535***	−0.086	−0.243**	−0.020	−0.480**	−0.265	−0.229*	−0.123
	(−3.02)	(−0.40)	(−2.37)	(−0.17)	(−2.34)	(−1.51)	(−1.94)	(−1.15)
Constant	−14.637***	21.202***	−10.429***	−0.637	6.026	16.208***	−2.748	2.691
	(−3.79)	(3.76)	(−4.47)	(−0.24)	(1.47)	(3.81)	(−1.31)	(1.00)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	13,820	13,588	13,820	13,588	13,650	13,486	13,650	13,486
R-squared	0.258	0.316	0.256	0.288	0.266	0.356	0.254	0.328

regression; however, incorporating regional and industry FEs in the robustness checks strengthens the study's internal validity by ensuring that omitted regional or sectoral factors do not cause the observed effects.

3.3. Heterogeneity analysis

With firms classified by median size threshold, Columns (1)–(4) of Table 4 show how circuit courts' policy effects differ by firm size. Circuit courts significantly minimize analyst forecast errors and dispersion for large firms. This may be attributed to large firms' complexity and stakeholders' increased desire for transparency. Enhanced judicial oversight improves information transparency and reduces forecast uncertainty. Large firms also attract market attention and public scrutiny, and the deterrent effect of circuit courts ensures disclosure regulation compliance. Moreover, broader analyst coverage of large firms increases the benefits of improved disclosure quality by lowering prediction dispersion and errors. By contrast, small firms, with simpler operations and lower market visibility, exhibit only moderate forecast quality gains after judicial oversight enhancements.

As illustrated in Table 4, Columns (5)–(8), the median leverage ratio divides firms into high- and low-leverage groups. Results show that circuit courts significantly negatively affect analysts' earnings forecast errors and forecast dispersion in high-leverage firms; however, no significant effect is observed for low-leverage firms. High-leverage firms have more information asymmetry and default risk, making transparent and reliable financial information crucial for creditors, investors, and analysts. However, these firms use earnings management and opportunistic financial reporting to influence market perception, worsening information asymmetry. In this context, establishing circuit courts strengthens legal enforcement, reduces regulatory arbitrage, and enhances market discipline, thereby mitigating financial information manipulation and forecast errors and dispersion. Meanwhile, low-leverage firms are less reliant on debt financing and experience lower financial distress risk, resulting in fewer regulatory restraints imposed by creditors. Given their limited reliance on external financing, judicial oversight and legal enforcement exert a weaker influence on their financial disclosure practices.

3.4. Mechanism analysis

The internal control index was introduced as a moderating variable to examine how the establishment of circuit courts affects analysts' earnings forecast quality (Chen et al., 2017). The results in Columns (1) and (2) of Table 5 show that the interaction term between circuit court establishment and the internal control index positively affects analysts' forecast errors. This finding suggests that internal control reduces prediction quality improvement in circuit courts. Specifically, stronger internal controls lead to more consistent disclosure practices, reducing information asymmetry, thereby lowering forecast errors. However, circuit courts improve judicial efficiency, reduce government intervention, and improve market transparency; however, they offer little information to highly transparent firms. As a result, analysts may worry more about legal risks and compliance costs, increasing forecast uncertainty. Regulatory change adaption costs are also crucial. Strengthened judicial oversight compels firms to revise financial and compliance plans, increasing financial complexity and making it harder for analysts to assess firms' financial conditions in the short term, affecting forecast accuracy.

The management expense ratio was added as a moderating element to examine the impact of circuit court establishment on analysts' earnings estimate quality. The results in Table 5, Columns (3) and (4), reveal that the management expense ratio significantly

Table 5
Results of mechanism analysis.

Variables	(1) *FERROR*	(2) FDISP	(3) *FERROR*	(4) *FDISP*	(5) *FERROR*	(6) *FDISP*
Court	−0.364**	−0.168**	−0.364***	−0.182**	−0.297*	−0.101
	(−2.52)	(−2.05)	(−2.66)	(−2.36)	(−1.74)	(−1.02)
*Court*Internal Control Index*	0.001**	0.001***				
	(1.97)	(3.55)				
Internal Control Index	−0.003***	−0.001***				
	(−5.64)	(−4.55)				
*Court*Management Expense Ratio*			−0.009	−0.046***		
			(−1.34)	(−9.50)		
Management Expense Ratio			0.002**	0.001***		
			(2.03)	(3.66)		
*Court*Information Disclosure Quality*					−0.327**	−0.334***
					(−2.09)	(−4.01)
Information Disclosure Quality					0.904***	0.473***
					(7.62)	(7.07)
Constant	8.074***	−2.184	9.314***	−2.101	9.822***	−2.322
	(2.68)	(−1.48)	(3.23)	(−1.49)	(2.98)	(−1.42)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	25,520	25,520	27,747	27,747	20,850	20,850
R-squared	0.260	0.243	0.247	0.234	0.278	0.259

positively affects analysts' forecast errors, whereas the interaction term between circuit court establishment and the management expense ratio is significantly negative. This suggests that analysts struggle to effectively analyze financial conditions in firms with higher managerial expenses owing to lower transparency and financial complexity, resulting in increased forecast errors. However, the establishment of circuit courts improves judicial oversight, reduce government intrusion, and streamline legal enforcement. Hence, firms face stricter legal constraints, enhancing market transparency and reducing analysts' forecast errors. A high management expense ratio frequently indicates inefficient resource allocation, elevated agency costs, or excessive administrative spending, which can lower financial disclosure quality and exacerbate information asymmetry, making forecasting harder. By contrast, circuit court establishment forces corporate management to improve compliance, reduce unnecessary expenditures, optimize resource allocation, and improve financial transparency, giving external investors and analysts more reliable and accurate information and improving forecast precision.

Information disclosure quality was also examined as a moderating variable in the link between circuit court establishment and analysts' forecast quality. The results in Table 5, Columns (5) and (6), show that the interaction between circuit court establishment and information disclosure quality is significantly negative, whereas information disclosure quality alone significantly positively affects analysts' forecast errors. Although higher-quality disclosure may increase forecast errors owing to the complexity of financial information, circuit courts address this issue by improving market transparency and forecast accuracy. An increase in disclosure quality does not necessarily result in lower forecast errors; rather, it can introduce greater complexity in financial statements, industry reports, and managerial discussions, which increases analysts' cognitive burden and information overload, which increases forecast uncertainty. Circuit courts improve legal oversight, enhance judicial independence, and limit government intervention, standardizing and credibly enhancing corporate disclosure standards. Under these conditions, analysts may process and interpret financial information more efficiently, reducing the adverse effects of information complexity on forecast accuracy. This explains the negative interaction effect between circuit courts and information disclosure quality.

4. Conclusion

Using data from Chinese A-share listed companies from 2010 to 2021, this study examines the impact of judicial quality improvements, notably the establishment of circuit courts, on analysts' earnings forecast accuracy. Findings reveal that circuit courts significantly reduce analyst forecast errors and dispersion, highlighting the need of increased judicial oversight in strengthening corporate disclosure transparency, mitigating information asymmetry, and improving forecast accuracy and consistency. Heterogeneity analysis indicates that the policy effects are more pronounced in large firms and those with high leverage, where disclosure demands are higher and judicial enforcement is more effective. Furthermore, the moderating effects of internal control, management expenses, and information disclosure quality suggest that circuit courts play an important role in improving financial transparency and forecast accuracy, especially in firms with weaker governance, higher management costs, or complex disclosure practices.

Based on the study's findings, policymakers should broaden circuit court jurisdiction and boost judicial enforcement to improve financial disclosure quality, market efficiency, and investor confidence. Establishing specialized financial courts could help to improve corporate governance monitoring. Circuit courts have a greater impact on large and high-leverage firms; thus, judicial reforms should be supplemented by targeted regulatory measures for small and low-leverage firms, such as incentivizing voluntary disclosure and improving external audits to reduce information asymmetry. Furthermore, given the moderating effects of internal control, management expenses, and disclosure quality, judicial reforms should be aligned with corporate governance policies to strengthen compliance, deter financial misreporting, and improve regulatory coordination, resulting in a more transparent and stable capital market.

CRediT authorship contribution statement

Shen Tang: Visualization, Supervision, Resources, Methodology, Formal analysis, Conceptualization. **Chuan Qin:** Writing – review & editing, Validation, Methodology, Funding acquisition, Conceptualization. **Feng Qi:** Writing – review & editing, Visualization, Software, Methodology, Funding acquisition, Formal analysis, Conceptualization.

Declaration of interests

The authors declare that they have no known competing financial interests or personal relationships that might influence the work reported in this paper.

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Data availability

Data will be made available on request.

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