



# Political uncertainty and analysts' forecasts: Evidence from China

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## ARTICLE INFO

### Keywords:

Political uncertainty  
Analysts' earnings forecast  
Forecast accuracy  
Forecast dispersion  
Political turnover

### JEL code:

G20  
G10  
M40

## ABSTRACT

We examine the impact of political uncertainty on analysts' earnings forecast accuracy and forecast dispersion. Using the turnover of local government leaders in China, we find robust evidence that there is a reduction in forecast accuracy and an increase in forecast divergence in the presence of political uncertainty. Further, we document the negative relationship between political uncertainty and forecast accuracy is more pronounced when the level of political uncertainty is higher and when companies are more sensitive to political uncertainty. Our findings extend our understanding of political uncertainty to analysts' behaviors.

## 1. Introduction

There is a growing body of literature that recognizes political uncertainty has a significant impact on corporate behaviors, including corporate investment (Julio and Yook, 2012; An et al., 2016; Jens, 2017), corporate financing decisions (Gao and Qi, 2014; Çolak et al., 2017) and accounting choice (Bu et al., 2015; Dai and Ngo, 2018). So far, very little attention has been paid to the influence of political uncertainty on analysts' behaviors. As professional information intermediaries, analysts can play an important role in reducing information asymmetry between companies and investors. It has previously been observed that uncertainty arising from changes in macroeconomic conditions or crisis events affects analysts' behaviors (Arand and Kerl, 2012; Amiram et al., 2018; Loh and Stulz, 2018). There is little evidence about whether uncertainty induced by government officials' turnover influences analysts' earnings forecasts. This paper attempts to show how political uncertainty caused by turnovers of local government leaders affects analysts' forecasts, specifically, analysts' earnings forecasts accuracy and dispersion.

Political uncertainty could affect analysts' forecasting activities in both directions. On the one hand, it could have an adverse effect on analysts' forecasts from various aspects. First, the change of business environment and fluctuations in policy arising from political uncertainty will make companies' earnings less predictable. Second, political uncertainty may cause companies to alter their decisions, like hold more cash (Xu et al., 2016), reduce investment (Julio and Yook, 2012) and delay financing (Çolak et al., 2017). These likely changes may increase the level of information asymmetry between the analyst and the company. Thus, providing accurate forecasts is likely to be more challenging when political uncertainty is high. Uncertainty may make investors' beliefs more dispersed (Choi, 2019). Different analysts may have different judgments about the companies' situation under political uncertainty. Some analysts with superior information sources may perform much better than others. So political uncertainty may make analysts' forecasts less convergence. On the other hand, the demand for information will increase during periods of political uncertainty,

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<https://doi.org/10.1016/j.frl.2019.101340>

Received 27 May 2019; Received in revised form 18 October 2019; Accepted 21 October 2019

Available online 22 October 2019

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analysts may work harder to produce accurate information (Loh and Stulz, 2018). Less capable analysts may quit following the company under high political uncertainty. If so, analysts' earnings forecasts will be more accurate and show more consistency. Therefore, the impact of political uncertainty on analysts' earnings forecast accuracy and forecast dispersion is an empirical question.

China's government official's turnover provides a good setting for our research. First, the appointment, promotion and dismissal of local officials are controlled by the central government. This system provides a strong motivation for local officials to increase local economic growth (Li and Zhou, 2005). A new local government leader may alter government policies and re-allocate resources in order to outstanding his performance (Piotroski and Zhang, 2014). Thus, the turnover of local government leaders may induce huge uncertainty about the change of government policies, regulation and resource allocations. Second, politics and politicians have a much stronger influence on business in China, previous studies finds that political uncertainty makes companies reduce investment (An et al., 2016) and hold less cash (Xu et al., 2016), increase a company's cost of equity (Li et al., 2018a) and reduce the idiosyncratic information about a company (Chen et al., 2018). The political incentive plays an important role in the Chinese market (Piotroski et al., 2015). The influenced has been observed on various market participants, not only companies, but also auditors (Yang, 2013) and media (You et al., 2017). It is interesting to extend this line of research to analysts. We manually collect the data about the turnovers of the Communist Party secretaries of different cities across different years. Local government leaders normally server five-year terms and some changes may happened before the officials' tenure. The staggered events enable us to distinguish high political uncertainty periods for certain companies from other periods.

The objective of this study is to examine the relationship between political uncertainty and analysts' earnings forecast accuracy and dispersion. Using local government leaders' turnovers at the city level in China, we identify years when the Communist Party secretary (the local government leader) of the city where the company registered changed as high political uncertainty periods. We find that political uncertainty is associated with less accurate analysts' earnings forecasts and greater forecast dispersion. Further, the reduction in forecast accuracy is more pronounced when the political uncertainty is more severe and when the companies are more political dependent. Overall, our findings suggest that political uncertainty has an adverse effect on analysts' forecasts.

Our study contributes to the literature in several ways. First, we provide new evidence on how political uncertainty influence analysts' behavior in emerging market, while existing study focuses on developed markets (Baloria and Mamo, 2017). Second, we supplement the research examining the relationship between uncertainty and analysts' forecasts. Previous research mostly focuses on macroeconomic uncertainty. We extend it to political uncertainty, which is a particular aspect of uncertainty. Third, we add to the stream of literature that examines information opacity in emerging markets. The political uncertainty in emerging markets could have an adverse effect on information environment by influencing analysts' forecasts.

## 2. Data and methods

### 2.1. Data and sample

We collect analysts' earnings forecasts for all Chinese A-share companies from 2005 to 2016 and other analyst information from CNRDS (Chinese Research Data Services Platform).<sup>1</sup> We delete earnings forecasts with missing analyst information and only keep one year ahead forecasts following prior studies (Duru and Reeb, 2002; He et al., 2019). We only retain the last forecast before the earnings announcements if there are multiple earnings forecasts issued by the analyst for the same company in a given year. Company registration and other information come from CSMAR (China Stock Market and Accounting Research databases). We exclude observations without the required information. Finally, we have 10,854 firm-year observations, containing 1847 unique companies registered in 223 cities. For measuring political uncertainty, we collect the turnover of the Communist Party secretaries at the city level. We get Communist Party secretaries' turnover data across 235 cities from 2005 to 2016.

### 2.2. Research design

We employ the following model to examine the influence of political uncertainty on analysts' earnings forecasts characteristics:

$$\begin{aligned} Accuracy_{i,t}(Disp_{i,t}) &= \alpha_0 + \beta_1 Puncertainty_{i,t} + \beta_2 SIZE_{i,t-1} + \beta_3 BM_{i,t-1} + \beta_4 GROWTH_{i,t-1} \\ &+ \beta_5 LOSS_{i,t} + \beta_6 SDROA_{i,t} + \beta_7 INS_{i,t-1} + \beta_8 CSOE_{i,t} + \beta_9 LSOE_{i,t} \\ &+ \beta_{10} SUBSID_{i,t-1} + \beta_{11} FOLLOW_{i,t} + \beta_{12} HORIZON_{i,t} + \beta_{13} GENEXP_{i,t} \\ &+ \beta_{14} FRIMEXP_{i,t} + \beta_{15} STAR_{i,t} + \beta_{16} BROKERSIZE_{i,t} + \beta_{17} GDPG_{i,t} \\ &+ \beta_{18} GDPG_{i,t-1} + year\ effect + industry\ effect + \varepsilon \end{aligned}$$

We examine two properties of analyst earnings forecasts at the firm level, forecast accuracy and forecast dispersion. We measure the two properties follow previous studies (Duru and Reeb, 2002; Behn et al., 2008; Li et al., 2018b). The detail measurement can be seen in Table 1. For each firm-year observation,  $Puncertainty_{i,t}$  takes a value of one when the city where the company registered in experiences a Communist Party secretary turnover and zero otherwise.

We control for various characteristics of companies that may influence analyst forecasts following previous literature (Lang and

<sup>1</sup> Analysts only issue annual earnings forecasts in China.

**Table 1**  
Variable Definitions.

Variable Names	Definition
$Accuracy_{i,t}$	The average earnings forecast accuracy of the latest earnings forecast issued by each analyst for the company $i$ of year $t$ . Forecast accuracy is defined as the absolute value of the difference between the forecast and the actual EPS, scaled by the stock price at the beginning of the year, multiply by $-100$ .
$Disp_{i,t}$	The standard deviation of earnings forecast issued by each analyst for the company $i$ of year $t$ , scaled by the stock price of the company at the beginning of the year, multiply by $100$ .
$Puncertainty_{i,t}$	Equal to 1 if the Communist Party secretary in the registration city of the company $i$ in year $t$ changed, and 0 otherwise.
$HPuncertainty_{i,t}$	Equal to 1 if the communist party secretary in the registration city of the company $i$ changed before the end of his term in year $t$ , and 0 otherwise.
$SIZE_{i,t-1}$	The natural log of the market capitalization of equity at the end of the previous year.
$BM_{i,t-1}$	Book to market ratio measured at the end of the previous year.
$GROWTH_{i,t-1}$	The growth rate of revenue of company $i$ in the previous year.
$LOSS_{i,t}$	Equal to 1 if the company's net profit is negative in year $t$ , and 0 otherwise.
$SDROA_{i,t}$	The standard deviation of the company's ROA during the last five years.
$INS_{i,t-1}$	Share ownership percentage of institutional investors at the end of the previous year.
$CSOE_{i,t}$	Equal to 1 if the company is controlled by the central government, and 0 otherwise.
$LSOE_{i,t}$	Equal to 1 if the company is controlled by a local government, and 0 otherwise.
$SUBSID_{i,t-1}$	Equal to 1 if the company receives government subsidies in the previous year, and 0 otherwise.
$FOLLOW_{i,t}$	The natural logarithm of the number of analysts covered the company $i$ in year $t$ .
$HORIZON_{i,t}$	The average horizon of all analysts following the company $i$ in year $t$ . The horizon is the natural logarithm of the number of days between forecast and earnings announcement.
$GENEXP_{i,t}$	The average general experience of all analysts following the company $i$ in year $t$ . General experience is the number of years since the analyst first provides an earnings forecast.
$FIRMEXP_{i,t}$	The average firm-specific experience of all analysts following the company $i$ in year $t$ . Firm-specific experience is the number of years since the analyst first provides an earnings forecast for a certain company.
$STAR_{i,t}$	The average star rating of all analysts following the company $i$ in year $t$ . The Star rating equals 1 if the analyst (If it is an analyst team at least one analyst) is an "all-star" analyst according to the New Fortune Best Analysts Survey in China, and 0 otherwise.
$BROKERSIZE_{i,t}$	The average brokerage size of all analysts following the company $i$ in year $t$ . The brokerage size is the natural logarithm of the number of analysts employed by the brokerage firm in year $t$ .
$GDPG_{i,t}$	The GDP growth rate of the registration city of the company $i$ in year $t$ .
$GDPG_{i,t-1}$	The GDP growth rate of the registration city of the company $i$ in year $t-1$ .

Lundholm, 1996; Hope, 2003; Behn et al., 2008; Hong and Kacperczyk, 2010; Dichev and Tang, 2009; Leavy et al., al.,2011), including size, book-to-market ratio, sales growth, accounting loss, earnings volatility, institutional holdings and the number of analysts following the company. We also control for whether the company is controlled by local government or central government and whether it received government subsidies in the previous year. Some analyst characteristics that prior research identifies as affecting forecast accuracy (Clement, 1999; Li et al., 2018b) is also included in our model (including  $HORIZON_{i,t}$ ,  $GENEXP_{i,t}$ ,  $FIRMEXP_{i,t}$ ,  $STAR_{i,t}$  and  $BROKERSIZE_{i,t}$ ). For these variables, we use the average value of all analysts following the company. Considering the turnover of local government leaders is probably influenced by local macroeconomic performance, we use two variables about the GDP growth rate of the city to control this effect following Xu et al. (2016). Finally, we include industry and year fixed effects to control for unobservable factors that affect the predictability of firm earnings in different industries and years. All continuous variables are winsorized at the 1% and 99% levels. The detail of variable definitions can be seen in Table 1.

### 3. Empirical results

#### 3.1. Summary

Panel A of Table 2 reports the frequency of the turnovers of local government leaders in our sample. The percentage of cities with a turnover of party secretaries ranges from 10.80% to 36.41% in different years. We present descriptive statistics for the sample of 10,854 firm-year observations in Panel B of Table 2. The mean value of  $Puncertainty$  is 0.257, suggesting that there are about one-fourth observations are earnings forecasts issued to companies that under political uncertainty.

#### 3.2. Main results

Table 3 presents the results investigating the relationship between political uncertainty and analyst earnings forecasts characteristics. The univariate analyses in Panel A provide preliminary evidence that analyst forecast accuracy is significantly lower for companies that under political uncertainty than other observations ( $-1.994$  vs  $-1.585$ ) and analyst forecast dispersion is significantly higher for these companies than others ( $1.165$  vs  $1.031$ ). Panel B of Table 3 reports the regression results.<sup>2</sup> The coefficient of  $Puncertainty$  is significantly negative at the 1% level ( $-0.5044$ ,  $t = -12.072$ ) in the accuracy model, suggesting that forecast

<sup>2</sup> The results of control variables are not displayed because of limited space.

**Table 2**  
Sample and Summary.

Panel A: Sample Distribution						
Year	2005	2006	2007	2008	2009	2010
Turnover of party secretaries	31	34	43	60	19	27
Total number of cities	129	148	149	160	176	173
%	24.03	22.97	28.86	37.50	10.80	15.61
Year	2011	2012	2013	2014	2015	2016
Turnover of party secretaries	50	60	67	32	54	57
Total number of cities	175	191	184	187	192	197
%	28.57	31.41	36.41	17.11	28.13	28.93

  

Panel B: Summary						
Variables	Mean	STD	Min	Median	Max	Obs
$Accuracy_{i,t}$	-1.690	2.363	-15.503	-0.961	-0.047	10,854
$Disp_{i,t}$	1.064	1.226	0.000	0.691	7.479	9273
$Puncertainty_{i,t}$	0.257	0.437	0.000	0.000	1.000	10,854
$HPuncertainty_{i,t}$	0.084	0.277	0.000	0.000	1.000	10,854
$SIZE_{i,t-1}$	22.320	1.016	20.259	22.247	25.772	10,854
$BM_{i,t-1}$	0.545	0.256	0.088	0.521	1.115	10,854
$GROWTH_{i,t-1}$	0.217	0.472	-0.489	0.131	3.216	10,854
$LOSS_{i,t}$	0.071	0.257	0.000	0.000	1.000	10,854
$SDROA_{i,t}$	0.031	0.042	0.001	0.019	0.301	10,854
$INS_{i,t-1}$	6.785	9.260	0.000	4.024	58.820	10,854
$CSOE_{i,t}$	0.158	0.365	0.000	0.000	1.000	10,854
$LSOE_{i,t}$	0.351	0.477	0.000	0.000	1.000	10,854
$SUBSID_{i,t-1}$	0.803	0.398	0.000	1.000	1.000	10,854
$FOLLOW_{i,t}$	1.864	1.136	0.000	1.946	3.932	10,854
$HORIZON_{i,t}$	5.158	0.524	3.082	5.237	6.028	10,854
$GENEXP_{i,t}$	2.095	1.223	0.000	2.000	7.000	10,854
$FIRMEXP_{i,t}$	0.479	0.496	0.000	0.364	2.286	10,854
$STAR_{i,t}$	0.191	0.220	0.000	0.147	1.000	10,854
$BROKERSIZE_{i,t}$	3.916	0.554	2.292	3.957	5.159	10,854
$GDPG_{i,t}$	0.126	0.075	-0.140	0.115	0.370	10,854
$GDPG_{i,t-1}$	0.140	0.074	-0.069	0.131	0.388	10,854

Notes: All variables are as defined in Table 1. Disp is only existed when the company is followed by more than one analyst, so our sample size declined to 9273.

**Table 3**  
The Relationship Between Political Uncertainty and Analysts Earnings Forecasts.

Panel A: Univariate Analysis						
	$Puncertainty = 0$		$Puncertainty = 1$		t-test	z-test
	n	mean	n	mean		
$Accuracy$	8069	-1.585	2785	-1.994	7.889***	16.837***
$Disp$	6908	1.031	2365	1.165	-4.640***	-5.483***

  

Panel B: Multivariate Regression		
	(1) $Accuracy_{i,t}$	(2) $Disp_{i,t}$
$Puncertainty_{i,t}$	-0.5044*** (-12.072)	0.1907*** (7.206)
Controls	YES	YES
IND	YES	YES
YEAR	YES	YES
N	10,854	9273
adj. R-sq	0.384	0.229

Notes: All variables are as defined in Table 1. In Panel B, numbers in parentheses represent t-values based on standard errors clustered by the company. \*, \*\*, and \*\*\* indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

accuracy decreases in the presence of political uncertainty. The coefficient of *Puncertainty* is significantly positive at the 1% level (0.1907,  $t = 7.206$ ) in the dispersion model, indicating that political uncertainty is positively associated with analysts' forecast divergence. In summary, political uncertainty negatively affects analysts' earnings forecast accuracy and positively affects analysts' earnings forecast dispersion. The empirical evidence suggests that political uncertainty makes the analyst forecasting task more complex and more difficult.

**Table 4**  
Factors that Moderate the Relationship between Political Uncertainty and Forecast Accuracy.

	(1) <i>Accuracy<sub>i,t</sub></i>	(2) <i>Accuracy<sub>i,t</sub></i>	(3) <i>Accuracy<sub>i,t</sub></i>
<i>Puncertainty<sub>i,t</sub></i>	−0.3830*** (−7.909)	−0.4100*** (−7.688)	−0.3028*** (−2.935)
<i>HPuncertainty<sub>i,t</sub></i>	−0.3744*** (−4.888)		
<i>LSOE<sub>i,t</sub>*Puncertainty<sub>i,t</sub></i>		−0.2529*** (−2.735)	
<i>CSOE<sub>i,t</sub>*Puncertainty<sub>i,t</sub></i>		−0.0493 (−0.392)	
<i>SUBSID<sub>i,t-1</sub>*Puncertainty<sub>i,t</sub></i>			−0.2480** (−2.214)
<i>Controls</i>	YES	YES	YES
<i>IND</i>	YES	YES	YES
<i>YEAR</i>	YES	YES	YES
<i>N</i>	10,854	10,854	10,854
adj. R-sq	0.386	0.385	0.384

Notes: All variables are as defined in Table 1. Numbers in parentheses represent t-values based on standard errors clustered by the company. \*, \*\*, and \*\*\* indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

### 3.3. Further analysis and robust tests

The influence of political uncertainty on analyst earnings forecasts can be varied across different levels of uncertainty and different companies. We first analyze how the degree of political uncertainty affects our results. Some official changes occur when the previous tenure ends, and some changes occur during the tenure. The second one is more difficult to predict and may bring more uncertainty. We construct an indicator variable *HPuncertainty*, it equals to one if the city party secretaries are being replaced before his tenure ends and zero otherwise. The results in Column (1) in Table 4 show that earnings forecast accuracy decreases more when the degree of political uncertainty is higher.

The political uncertainty makes the future of the company less predictable, the effect should be stronger for companies that are more sensitive to local political uncertainty. We use two ways to distinguish companies that are more political dependent, the first one is whether the company is controlled by the local government, and the second one is whether the company receives government subsidies in the previous year. The coefficient of *LSOE\*Puncertainty* is significantly negative in column (2) of Table 4 and the coefficient of *CSOE\*Puncertainty* is not significant, suggests that the influence of local government leaders' turnover are more significant for local SOEs. The coefficient of *SUBSID\*Puncertainty* is also significantly negative in column (3) of Table 4. The results show that the adverse effect of political uncertainty on forecast accuracy is more pronounced for companies that are more sensitive to local political uncertainty.<sup>3</sup>

We conduct several tests to ensure our empirical evidence is robust. First, we use a matching method. For each treatment observation (firm-year that experiences official turnover), we match a control observation (firm-year that does not experience official turnover), which is located in the same province, in the same industry, and has the nearest value of size. The results are consistent in the matched sample. Second, we change the measurement of analysts' earnings forecast accuracy, the accuracy is measured as the absolute difference between forecast earnings and actual earnings scaled by the absolute value of actual earnings, the value if multiplied by −1. Third, we add city fixed effect in our model, controlling for any unobservable time-invariant characteristic at the city level and it might mitigate the concern of the omitted variable issue. Fourth, we examine the relationship between political uncertainty and analyst earnings forecasts at the analyst level and add analyst fixed effect in the regression. In summary, the results are robust with all these changes. The robust test results are shown in Table 5.<sup>4</sup>

## 4. Conclusion

Extensive research has shown that political uncertainty has a significant influence on the market and company, but very little is currently known about the relationship between political uncertainty and analysts behaviors. We argue that political uncertainty may affect analysts' forecasts in various aspects, the net effect should be examined by empirical analysis. The turnover of local government leaders in China provides us a good setting to test it. The empirical evidence shows that analysts' earnings forecasts are less accurate and less convergence for companies under high political uncertainty. In addition, we also document that the adverse effect of political uncertainty on analysts' forecast accuracy is stronger when the political uncertainty level is high and when the company is more political dependent. Collectively, our results suggest that political uncertainty complicates the forecasting of analysts. It provides new evidence about how analysts are influenced by political factors in emerging markets. These findings extend our understanding of

<sup>3</sup> The empirical results suggest the effect of political uncertainty on forecast dispersion is not affected by these factors.

<sup>4</sup> The results of robust tests for forecast dispersion are also consistent with our main results.

**Table 5**  
Robust Tests.

	(1) <i>Accuracy<sub>i,t</sub></i>	(2) <i>Accuracy<sub>i,t</sub></i>	(3) <i>Accuracy<sub>i,t</sub></i>	(4) <i>Accuracy<sub>i,t</sub></i>
<i>Puncertainty<sub>i,t</sub></i>	−0.4139*** (−6.248)	−0.1116** (−2.224)	−0.5012*** (−11.869)	−0.5570*** (−16.790)
<i>Controls</i>	YES	YES	YES	YES
<i>IND</i>	YES	YES	YES	YES
<i>YEAR</i>	YES	YES	YES	YES
<i>CITY</i>			YES	
<i>ANALYST</i>				YES
<i>N</i>	3870	10,854	10,854	122,578
adj. R-sq	0.385	0.076	0.396	0.406

Notes: This table presents the results of robust tests. The results using the matched sample are reported in Column (1), Column (2) contains the results using another measure of accuracy, Column (3) shows the results of the regression model that includes city fixed effect and Column (4) is the results of regression at analyst level and includes analyst fixed effect. All variables are as defined in Table 1. Numbers in parentheses represent t-values based on standard errors clustered by the company. \*, \*\*, and \*\*\* indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

political uncertainty to information intermediaries and enrich our knowledge about factors that affect information dissemination in emerging capital markets.

## Acknowledgments

This work was supported by National Natural Science Foundation of China (Grant Nos. 71472148).

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