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Post-Earnings Announcement Drift in China's A-Share Market: An Integrated Analysis

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Abstract

This paper examines the Post-Earnings Announcement Drift (PEAD) in the Chinese A-share market. As an overview of the researches carried out from 2011 to 2023 for evaluating why this significant anomaly is still economically and theoretically relevant in emerging countries. As a prevalent market anomaly, PEAD refers to the persistent directional deviation of stock prices following corporate earnings releases. Classical models cannot explain PEAD well. Even after continuous improvements in market reform and development of trade infrastructure, the delay in reflected reaction has yet to fully reconcile with established theories. To explain such persistent inefficiency, this paper constructs a framework combining psychology and structure. Investor inattention explains the under-reaction to earnings. Structural constraints, such as short-sale restrictions, prevent the arbitrageurs from correcting mispricing. Furthermore, based on the above analysis results, different kinds of environmental conditions have been identified to cause changes by means of drifts. Empirical evidence indicates that, recent studies have found that institutional investors may not eliminate this anomaly but rather strengthen or amplify it due to momentum herd behavior in a high-transparent situation. Finally, in terms of understanding behavioural finance at multiple angles through this model; thus possessing considerable value for both theory and practice.

Keywords

post-earnings announcement drift, limited investor attention, arbitrage constraints, institutional herding, China’s A-share market

1. Introduction

Market efficiency constitutes the core paradigm of modern financial research. The Efficient Market Hypothesis (EMH) assumes that asset prices reflect all available information. Under a more restrictive interpretation of this model, new corporate financial data must be fully adjusted immediately with no exception or biases regarding the assessment. However, strong market anomalies challenge it. Among them, the Post-Earnings Announcement Drift (PEAD) is one of the strongest ones. Initially documented in the context of the United States equity market by Ball and Brown [1] and subsequently formalized as a persistent delayed price response by Bernard and Thomas [2], PEAD is a drift that follows unexpected earnings announcements. Prices drift in the same direction. It can last for weeks or months. These results contradict the semi-strong version of

EMH. This implies that stock prices should instantly react to new public information. Rather than a quick adjustment, there is instead a prolonged stage during which abnormal gains can be achieved through the purchase of companies reporting positive earnings surprise and sale of those with negative earnings surprises. Widely documented across global capital markets, PEAD requires in-depth theoretical and empirical investigation.

China's A-share market provides a distinctive and ideal research context for examining PEAD due to its unique market microstructure. Retail investors have a strong presence in the market. In contrast to the advanced maturity of western markets, which are mainly institutional investors' domain, there are hundreds of millions of individuals in China's market with low retention rate but high sensitivity to emotions. Furthermore, the regulatory environment is evolving through economic reform. Government often intervenes in the market. Information environment is different from the West. There could be more room for behavioral biases. These particular attributes provide a good setting to identify the causes of market inefficiency in psychology and structure. Since there are still some underlying frictions that cannot be eliminated after strict short-selling restrictions and complex information disclosure channels were relaxed recently, it provides an opportunity to examine the effect of behavioural underreaction on arbitrage limit violations through this mechanism.

This paper aims to verify the persistence and economic implications of PEAD in contemporary China's evolving capital market, systematically synthesizing the multi-faceted determinants of this enduring anomaly across firm and market levels. However, empirical verification shows that there may be some abnormalities in the System; more systematic investigations need to be carried out to integrate scattered theoretical frames. Consequently, this paper identifies gaps in the field. PEAD has been observed in China. However, explanations integrating psychology and structure are scarce. This paper integrates findings from recent studies. The findings are integrated into an explanatory framework. It combines the relevant areas of investor psychology and market structure. This integrated approach provides more explanations than single-factor approaches. Based on about 2011-2023 research, by anchoring the discussion in the fundamental study, this article bridges the gap between behavioural bias and micro-structural constraint, thereby providing an all-encompassing picture of the life cycle of anomalies.

2. Literature Review

2.1 Limited Attention and Information Processing

Limited attention is one of the key mechanisms. Attention is limited. The brain cannot process all information. This causes slow reaction on market-moving information. This is very clear for the PEAD. Under the high-level digitalisation of the financial ecosystem today, market participants receive a tremendous amount of macroeconomic information, industry updates, and company-specific announcements daily. Cognitive psychology in finance states that when people's cognition exceeds certain limits, they tend to use heuristic methods and selectively concentrate their attention. Chen, Gao, and Liu [3] show that due to the abundance of retailers on China's market, attention deficiency is more evident. Multiple firms' announcement of earnings simultaneously; When earnings fall on a busy trading day - due to inattentiveness caused by competing information, price will greatly over-react to the true fundamentals reflected by the earnings deviation.

Moreover, there are many different types of attention. Chen, Diao and Wu [4] distinguish between retail and institutional cognition based on abnormal internet search volume data. They find that heterogeneous attention has a significant impact on the path of PEAD; in particular, enhanced retail attention tends to be associated with speculation noise and information ambiguity rather than resolution, thus exacerbating the drift. Non-retail Attention usually represents an objectively unbiased view. Consequently, investor inattention is a typical example. Investor herding is another one. Based on this, Shu and Tan [5] also conclude that there are various recognitions of anticipated future cash flows due to attention disengagement. Resulting investor opinion divergence impedes efficient price convergence and intensifies post-announcement price volatility.

Mild macroeconomic distortions have, in general terms at the level of individual enterprises. Du et al. [6] examine the periods of extreme macroeconomic instability using an economic policy uncertainty (EPU) index. As a result of the increase in EPU, Investors will have less time to pay attention to financial reports and may

attempt to analyse changes in policies for investment decisions. The reallocation of attention is likely to further worsen the overreaction at the firm level, as shown by these two points.

2.2 Arbitrage Constraints and Market Frictions

Arbitrage should normally correct mispricing. However, various constraints can prevent it. China has unique structures that could maintain this anomaly. The skill arbitrider will buy undervalued and sell overvalued securities in response to the earnings report's price shock as soon as possible so that the stock price can reach a more appropriate level of fairness. In fact, due to institutions' and structures', the A-share market cannot be arbitraged according to textbooks at all times.

Short-sale restrictions are crucial. Trading costs and idiosyncratic risk are barriers. Traditionally, there was an absolute ban on short selling in China's markets historically. Starting from 2010, as a result of continuously launching margin trading and short-sale trial projects in China's securities market, entry is limited to only qualified-listed firms, and debt funds are hard to obtain. Chang, Luo and Ren [7] used the phased lifting of these restrictions as a quasi-randomised control group to prove that after relaxing short-selling constraints, price efficiency has been significantly improved and lagged reactions have been reduced. Conversely, for the vast majority of non-eligible stocks, high trading cost and idiosyncratic risk erode expected profits. The slow reactions do not justify the initial mispricing. This explains why rational investors do not exploit the opportunity. Truong [8] also mentioned that it is impossible to short-sell stocks fundamentally, which will cause a significant asymmetry of drift; negative earnings surprises have been driven lower by a longer period due to the lack of mechanisms such as bets against shares being implemented.

Multiple market structural imperfections further elevate arbitrage barriers and delay price correction. In addition, T+1 trading rule and daily price limit (circuit breaker), etc., mechanically hinder the speed of information transmission from sudden earnings announcements. If there has been an unforeseen adverse effect on earnings that warrants a greater than normal price adjustment within one day, it must be forcedly spread over multiple consecutive trading days to ensure the resulting post-announcement fluctuation exceeds arbitrage capabilities.

2.3 Institutional Investors and the Amplification of Drift

We assume institutional investors correct retail investors' biases. Evidence shows that they can cause the drift to be stronger.At present's financial Model problem that institutions' Funds have advantageous conditions such as Advanced Research Equipment and Rich Data resources to which they mainly allocate in Market Allocation under circumstances of apparent inefficiency. They should be able to rapidly spot the behavioural mistakes of retailers and make trades in opposition. Empirical studies of the Chinese A-share market provide a contrast and contradiction to what is generally believed. Institutional investors can exacerbate its strength.

Cai et al. [9] provide solid evidence showing that domestic mutual funds and other institutions have not been able to perform their role of counter-trend stabilization after earnings announcement. Also among them was that some financial institutions were engaged in momentum trading to build stock holdings around earnings surprises and created trend-driven behaviour patterns. They follow the crowd. They would rather not underperform peers. This collective institutional herding behaviour acts as a large accelerator for the initial price movement by pulling it away from near-equilibrium status more severely and prolonging the drifting time.

The reason for this lack of effectiveness is the incentive systems controlling asset managers. There is also the problem of agency. Fund managers are pressured for short-term performance. Momentum strategy solves the problem. The compensation is usually relative, not absolute. This causes them to follow the trends. The arbitrage of a fund manager in an overpriced stock will be affected by this situation that takes time to recover; therefore, it has a certain degree of short-term underperformance relative to its target index. Managers rationally select to ride the wave of post-declaration protection for their career interests and secure relatively high compensation levels; Therefore, they have made this institutionalisation.

2.4 Information Environment, Media, Analyst Coverage, and Corporate Communication

Information shapes the speed of PEAD. The literature shows that its quality can affect the drift. How quickly the translation from profit information to market Price Changes requires strong supporting Infrastructure for

Surrounding Information Environment. A key pathway between raw accounting information and market value through a network including financial analysts, financial media, and the company's Investor Relation Department. Firms with higher analyst coverage have weaker PEAD. Analysts spread information. Through simplification of complex financial reports to produce basic estimates that minimise cognitive burdens on retail participants, short-circuit processing in early rounds, thus lowering the range of subsequent deviations.

In this way, the function of the financial media can also be seen as external controllers promoting price formation. Kim, et al. [10] found that the differences are quite pronounced in media coverage across different regions of mainland China; Because there are usually restrictions such as reporting regions or politics, some local media might not be able to give full account of the problems with their own business price biases. Non-local media has less dependence on external organizations or institutions; Its coverage shows a stronger negative correlation with the index of independent journalism and market inefficiency. Media coverage helps to spread information.

Quality of the reporting also matters. Quality reporting can cause the drift to be shorter. Complex reports can hide information. Third-party researchers, traditional mass media, as well as company's own proactive information releases have all affected News Event follow-throughs. Yang, Liu and Su [11] study the effects of post-earnings Communication Conferences. Find that although these conferences aim to clarify profits, their expressed attitudes of the company's management may help investors alleviate doubts or lead them into overreaction. In particular, if corporate reports are too complicated with flowery language and excessively upbeat without substantial support, they may fail to receive an accurate interpretation in time, thus causing the company's real economic situation to gradually unraveling.

3. An Integrated Analytical Framework

To thoroughly explain why PEAD persists within the A-shares, a singular-factors explanation is not sufficient enough. Based on behavioural neglect of reasons for irrational capital not stepping in and purely from arbitrage constraints that do not explain why the original under-reaction happens at all. Accordingly, this paper proposes a dual-stage integrated analytical framework.

The approach blends and amplifies behavioral finance theory. It illustrates that we cannot separate psychological and structural settings. Biases or frictions persist for long only alone. Their synergy constitutes the experience we see. At this time, psychological mechanism was mainly composed of three parts: investor's attention, cognitive overload due to competing information; And also opinion divergence. There is an inaccurate market pricing of the news at time zero. The second phase is structural restrictions, such as prohibition of short sales, daily price caps, high degree of idiosyncratic volatility and institutionalised conflicts of interest. Arbitrarily adjusted informed people cannot actively intervene in time to adjust. Humans' cognitive limitations, combined with the rigidity of a mature market Environment Reduce their development time Continuously. Table 1 systematically summarizes the core mechanisms, representative literature and theoretical implications of PEAD in China's A-share market.

Table 1: Core Mechanisms of PEAD in China's A-Share Market

Mechanism Category	Representative Literature	Implication for Post-Earnings Announcement Drift
Limited Attention & Opinion Divergence	Chen et al. [3]; Chen et al. [4]; Shu & Tan [5]; Du et al. [6]	Cognitive overload and heterogeneous processing capabilities create the initial delayed reaction. Macroeconomic uncertainty further distracts focus, extending the under-reaction phase.
Arbitrage Constraints & Market Frictions	Chang et al. [7]; Truong [8]	Lack of comprehensive short-selling infrastructure and high idiosyncratic risk prevent informed capital from forcibly correcting the initial mispricing, particularly for bad news.
Institutional Herding & Agency Costs	Cai et al. [9]	Career concerns and short-term performance benchmarks incentivize fund managers to herd on momentum rather than engage in fundamental arbitrage, exacerbating the drift's magnitude.
Information Environment & Transparency	Kim et al. [10]; Yang et al. [11]	High-quality, independent non-local media and transparent corporate communications accelerate price discovery. Opacity and capture sustain the anomaly.

4. Implications

4.1 Theoretical Implications

For academics, it is a step towards theory development in emerging markets. Traditional binary views of the efficient market hypothesis on complete efficiency or a fundamentally flawed market system in transitional Chinese economies are not sufficiently developed. Therefore, the persistence of PEAD proponents maintains an analogy with the adaptive markets hypothesis. The framework offers the foundation for a different conception of market efficiency. Markets are not entirely efficient. Nor are they completely inefficient. But, markets have different levels of efficiency, which are dependent on these behavioral and structural factors. It can be seen that Efficiency depends on context: A large-cap stock with strong market support and no short-selling restrictions will operate more efficiently, while a small-cap stock within the same exchange has substantial distortion because of its behaviour lags. Based on that area, researchers will construct an actual financial Model to assess how much the price increase has affected global assets within a certain period.

4.2 Practical Implications for Investors and Firms

For investors, it has implications for decision-making. Alpha factors in PEAD are not fully explained, so there is a need to be cautious about these phenomena. Exploit deviation caused by a sophisticated, quantifiable model of retail behaviour to identify whether there is an obvious change based on reasonable expectations. In addition, there are problems of transaction costs and inadequate implementation. Strategies of the so-called bad news may have restrictive options due to the struggling short-selling. Attempting to short an overvalued firm post-announcement is often logistically impossible or prohibitively expensive for all but the largest prime brokers. Therefore, risk management becomes critically consequential. Just like the constraints that provide the loophole for discrepancies, these constraints also plunge them in the risky situation, and the low liquid positions could bind investors for long.

For companies, it helps them understand how markets perceive their announcements. Only by publishing the results of corporate profits will it not be possible to accurately value the company in the stock market. For a company that wishes to avoid causing an extended period of mispriced-related volatlity, it should take active measures to strengthen its information system construction. Host transparent earnings disclosure meetings to actively communicate with all kinds of financial analysts, Simplifying the language structure of financial reports can significantly reduce investor engagement Costs; Speed up information release Efficiency, thus precisely achieves shareholder value realisation.

4.3 Regulatory and Policy Implications

For policy-makers, it provides support for the right regulations. Systematically enhance the information transmission effectiveness of the A-share market; The regulatory authority should take multiple measures to address both problems in the psychology of investors in retail business and the structural deficiencies that hinder arbitrage. On the behavioral front, Investor training can fill in the limits of attention. Financial literacy initiatives may improve brain capacity in processing data. Harmonization of disclosures can then drop down the processing costs. Set up a unified format system for earnings announcement on all stock exchanges without adding further regulatory requirements to the individual Stock Exchanges.

The construction of the market structure liberalisation can be further expanded continuously. Enablement of arbitrary trade can help to bring down structural restrictions. To be precise, the introduction of the gradual easing of short-selling could be endorsed as a monetary measure. Increase the number of stocks eligible for margin trading and short selling, reduce lending costs, thereby stimulating rational capital to boldly oppose behavioural mispricing. Finally, it is still unadjusted. The sustained regulation is one of the ingredients that reinforce the arbitrage. Rule modifications of the sort, which take place on a frequent basis, form uncertainty. This in turn discourages the long-term existence of arbitrage. The stability of rules encourages the corrective transactions.

5. Limitations and Future Research

The current review may have its limitations because it can only address a segment and may omit others. Considering that there is an extremely large amount of literature about Chinese market anomalies, the reviewed content naturally presents a single storyline focusing on attention and arbitrage constraints. Furthermore, the publication bias results in a situation in which study results are strongly positive. Information on the market keeps changing rapidly, hence not all developments are researched prior. Because academics are biased towards publications with statistical significance in abnormal events, there may not be enough research focusing solely on instances where the A-shares are entirely efficient.

The future research should focus on several issues. The long-term investigations taking into account PEAD as the market matures are the subject of great interest. Development of the scenes of different constraints' interactions is to be improved in this field. If laboratory tests can exactly extract single mechanisms, they will improve causal allegations. In addition, in the future, more empirical designs will need to be carried out with a focus on how various forms of regulatory oversight differ across the Main Board, ChiNext Tech Board and STAR Market-listed companies; To examine their effects separately. There are many highly fertile grounds for studying attention mechanisms through the expansion of localised social media platforms such as Eastmoney and Xueqiu, including those built on algorithms. Finally, relative studies in the cross-section of different emerging markets can add value to research. diverse markets impart different combinations for the same encumbrances. Contrasting them can thus display the critical determinants.

6. Conclusion

This analysis confirms that PEAD remains significant in China’s A-share market. Despite market tightness and the appearance of new rules, the PEAD phenomenon still persists. The risk-pricing approach fails to comprehensively explain PEAD. Although traditional asset pricing models aim to rationalise phenomena like the compensation for hidden risks; however, due to their significant predictability and size after-earnings drift has occurred in China, such rationalisation is impossible. Instead, the integrated framework gives a better explanation. The limited investor attention initiates the under-reaction driven through the structure constraints, most notably through short-sale restrictions. Institutional investors may, sometimes, exacerbate the issue. The information quality explains the distribution of the PEAD anomaly.

From two aspects of anomalies, managers and others can gain a better understanding of price discovery in the most active financial system at home through this research. Ultimately, China’s existing operational system is a case for behavioral finance. These distinctions set a particular and unique illustration of how the principles of finance are actually implemented in practice. In-depth observation and theoretical research in this space can help eliminate its peculiarity compared with the A-share market as a whole, thereby improving global public understanding about which factors affect market efficiency around the world more effectively.

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