

Explaining Share Price Disparity with Parameter Uncertainty: Evidence from Chinese A- and H-Shares

Tsz-Kin Chung

Hong Kong Monetary Authority

and

Ka-Fai Li

Hong Kong Monetary Authority

and

Cho-Hoi Hui

Hong Kong Monetary Authority
Hong Kong Institute for Monetary Research

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Summary

Despite having the same voting rights and dividend payments, the price disparity between the dual-listed Chinese firms in the A- and H-share markets (i.e., the AH share price disparity) is one of the most intriguing puzzles in the Mainland and Hong Kong financial markets.

This paper gives a new economic explanation of the AH share price disparity by investigating whether different assessments on the valuations and the risk of the dual-listed Chinese firms by Mainland and Hong Kong investors are a determinant of the disparity. The different assessments, which are due to information asymmetry and market segmentation with limited arbitrage between the two stock markets, could give rise to uncertainty of model-parameters used for pricing firms' equity values.

Using a firm's asset volatility as a measure of parameter uncertainty for pricing the firm's equity value, this paper finds that the measure is a robust determinant (in addition to the micro and macro factors identified in previous studies) of the AH share price disparity. Specifically, a one percentage-point increase in the level of parameter uncertainty would increase the price disparity by around fifteen percent on average. Parameter uncertainty is found to be related to a firm's market-to-book ratio of equity, its age and size, and global risk appetite in the financial market.

While with improved linkages between the two stock markets through better synchronisations in both accounting standards and information/financial disclosures, the magnitude of the price disparity has fallen markedly in recent years, yet the existence of the price disparity is inevitable in the presence of information asymmetry and market segmentation with limited arbitrage.

In view of the findings in this paper, parameter uncertainty could be a determinant of price disparity of other financial assets including the renminbi exchange rates in the onshore and offshore markets.