

Relationships between firm resources finance essay

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Introduction Relationships between firm resources and performance attract much research interest even though little is known about why some firms use resources successfully and others do not (Helfat, 2000)[1]. Extant literature suggests that superior performance comes from resource uniqueness (Barney, 1991)[2], reconfiguration and integration of existing resources (Eisenhardt and Martin 2000, Teece et al., 1997)[3, 4], and the ability to respond appropriately to the environment (Mintzberg, 1987; Pfeffer and Salancik, 1978; Tan and Litsschert, 1994)[5-7]. Scholars suggest that strategy and performance depend largely on the accessibility, timing, and amount of financial resources during development and new investments. Financial resources enable or constrain the strategic decision-making abilities of entrepreneurs and managers (Gilbert et al., 2006, Pissarides, 1999; Zou et al., 2010)[8-10]. Resource theorists suggest that a firm differs from another due to differences in sources of advantage (Peng, 2009)[11] and strategic orientations (Zhou and Li, 2010)[12]. Institutional theorists claim that sources of advantage are discovered due to differences in institution frameworks (DiMaggio and Powell, 1999; North, 1990; Oliver 1997; Peng 2002; Scott 1995)[13-16]. Firms have different levels of access to sources of financial capital because of variations in institutional frameworks. The China Security Regulatory Commission (CSRC) heavily regulates financing activities, so Chinese firms have unequal rights to finance and equity capital and bonds. Firms in other countries such as the US must fully and truthfully disclose information before financing operations. A regulatory body[1] facilitates only fair disclosures and information flow. In comparison, China's strict regulations create dissimilar access to equity

capital and bonds, so that some firms have better financial access than others (Li, 2009)[17]. According to the Fonseka et al. (2012), there are a large majority of literature on the relationship between equity financing and stock-price performance in develop market as well as emmerging markets. Those studies are focusing on the actual financing behavior such as issuings of equity, bonds and bank loans. However, few researches have been studied on the association between the capacity of a firm to raise external funds and stock-price performance. China have provided a unique setting for investigation of the stock market valuation of equity financing capacity because the listed firms in China have to fulfill specific requirements set by China Securities Regulatory Commission (CSRC) in order to become eligible to issue equity and debt securities[18]. The CSRC effectively defines a firm's capacity to issue equity and debt (Fonseka et al., 2012)[18]. Our aim was to examine whether the equity financing capacity, which defined as the eligibility to raise external equity capital through rights and public equity issuings as per CSRC regulations, is related to future stock returns. Private equity placements (PEPs) increased tremendously in developed and emerging markets over the last two decades. In 2006, the Chinese Security Regulatory Commission (CSRC) issued " the Measures for the Administration of the Issuance of Securities by Listed Companies" and placed PEPs on the regulatory constraints for first time in the Chinese capital market history. Private equity placement accounts for 85% of the number of firms and 81% of the value of seasonal equity financing during the period from 2006 to 2010. Hence, PEP was one of the most popular ways of equity refinancing in China during the sample period of this study. In recent years, investors of PE

have been focused to China for better returns. Chinese market is a focal point to international PE funds and important international private equity investors are continually looking on opportunities in China (Bortnick and Forry, 2009)[19]. This dissertation aims to analyze what is the role of equity financing regulations, how regulation process affects both issuing and non-issuance (competitor) firms' stock-price performance. We also examine whether the equity financing capacity affects market performance of listed Chinese firms. In this dissertation, we give special emphasis on private equity placement. In recent years, it becomes most famous and widely used equity financing mechanism in China. We study the effects of private equity placements on stock performance in long- and short-terms for both issuing and non-issuing firms. In this chapter, we introduce research background and rationale, research motivations and objectives, research methods, research framework, and research significance.

Research Background

Equity financing and stock-price performance was a hot topic in developed markets since last two decades. They study different type of equity issuance and stock-price performance at the time of issuing or post-issuing performance. Some researchers have been studying equity financing and stock-price performance in emerging markets. However, results are not consistent. Therefore, the study on equity financing and stock-price performance of Chinese firms is important in relation to emerging capital markets. Due to the transition nature of Chinese economy, Chinese stock markets function differ from those of major mature market economies in that the markets are heavily intervened by the administration (Bo et al., 2011)

[20]. Hence, Chinese capital markets also operate differently to the other emerging capital market due to the differences in institutional factors and tight regulations on firm financing through capital market. In China, equity financing has identified as a trouble free as it does not require the coupon payments and principal repayments associated with debt financing. So, firms need SEOs regardless of their financial needs (Ni, et al., 2010)[21].

Generally, bonds are a low-cost debt-financing option, but development of the Chinese bond market is far behind the stock market (Hirson, 2005; Leung and Young, 2002)[22, 23] and is the smallest corporate bond market in East Asia (Linton, 2006)[24]. The corporate bond market contributes only 1.4% of the total financial requirements of listed firms in China (Ni, et al., 2010)[21]. Then, listed Chinese firms tend to refinance from more equity than bond. Ni et al., (2010)[21] find that most listed Chinese firms were under-capitalized at their IPO, and to SEO arrive at a higher level of capitalization soon after the IPO issuance. Hence, number of seasoned equity issues is larger than other emerging stock markets. Two recent studies of Hsu, Reed and Rocholl (2011; 2010)[25, 26] find that equity financing was affect market performance of competitor firms. Chinese firms tend to offer more and more seasoned equity offerings after IPO. We suppose that seasoned equity financing could have effect on competitor's stock performance. Hence, there are several practical benefits and theoretical importance of studying the equity financing and stock-price performance of Chinese firms.

Practical Background

In this section, we present all practical importance and benefits of equity financing and stock-price performance in highly regulated Chinese market.

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Equity Financing Capacity and Stock-price Performance Since the economic reform in 1978 with the aim of transforming the central-command economic system into a market economy, China has become the largest and fastest-growing emerging economy in the world (Allen, Qian, and Qian, 2005; Ding, Zhang, and Zhang, 2007; Tian and Estrin, 2008)[27-29]. China maintains a government-dominated financial system in which the government tightly controls entry to banking and other financial services (Allen et al., 2008, Fan et al., 2008)[30, 31] and Chinese listed firms rely strongly on bank loan finance (Firth et al., 2008)[32]. China's politicians and bureaucrats strongly influence the allocation of bank loans: state ownership of banks means state control over most financial resources (Fan et al., 2008)[31]. Governments in many transition countries control key resources because of the lingering legacy of the command economy and slow development of market-supporting institutions (Li et al., 2008)[33]. Private entrepreneurs in transition economies face many obstacles. They are often denied access to bank loans and other key resources that are largely reserved for State-Owned Enterprises (SOEs) or are subject to heavy government regulations or "extralegal" fees (Guriev, 2004; Johnson et al., 2000; McMillan and Woodruff, 2002)[34-36]. By promulgating and enforcing economic policies and regulations, governments can directly change competitive environments (Hillman et al., 1999; Mahon and Murray, 1981; Shaffer, 1995)[37-39]. Government regulations create external uncertainties for the firm's operations (Lang and Lockhart, 1990)[40] and restrict capabilities for acquiring external resources (Khwaja and Mian 2005)[41]. In China, compared with more-developed countries, the state holds a significant stake

and greatly influences company operations, exerting enormous power in resource allocation and regulation enforcement (Nee 1992, Peng 1997, Tsai 2008, Wu and Cheng, 2011)[42-45]. SOEs enjoy preferential status in obtaining external finance and other key inputs (Brandt and Li, 2003; Che, 2002; Chow et al., 2010; Li et al., 2008; Poncet et al., 2010)[33, 46-49], while private firms are often denied access to external finance (Brandt and Li, 2003; McMillan, 1997; Nee, 1992)[36, 42, 46]. Government struggles to create fair market conditions so that private firms can compete (Li et al., 2008)[33]. Chinese firms face more constrained financial resources in the areas of market economies, performance, and competitive advantage (Peng and Heat, 1996)[33]. CSRC regulations and bureaucrats have more power than the developed market, then, to favor some firms and discriminate against others by influencing their access to sources of capital and finance. China's regulatory regime restricts Chinese firms in their ability to obtain funds through the financial markets. Its regulations define which firms can access different sources of financial capital and which firms can achieve an advantage. The issuance of securities in China is regulated by China Securities Regulatory Commission. The regulatory requirements are primarily determined by accounting-based quantitative and qualitative criteria. The basic quantitative criterion is that a firm must have met a minimum profitability threshold during a defined period. China's regulatory regime discriminates firms' access to equity finance. The requirements for becoming eligible to raise external capital essentially creates two types of firms; those eligible to raise external capital and hence have external financial capability and those that are not eligible and hence have constrained external

financing. We specifically examine whether the capacity to make rights and public offerings of equity is priced in the market in terms of future returns. Due to the tight controls and regulations related to access to public capital markets in China, only a portion of listed firms qualify to access public equity and debt markets in China. The capacity to raise external capital is an important intangible option available to the firm and could conceivably affect stock returns. Hence, the capacity for equity financing has important implications for various agents including investors, industry competitors, and issuing firms. Issuing companies comprise of a relatively small portion of portfolio value. It is therefore important for investors to know how equity financing capacity affects the stock market performance of existing firms when making portfolio allocation decisions. Similarly, firms which do not have capacity to equity finance that compete with the firms which have financing capacity need to understand how the equity financing affects their competitive environment, and how they can strategically respond to it. Findings of this study are also important for the regulators to understand effect of the regulations to the investors and firms. Private Equity Financing and Stock-price Performance of Issuing firms

In 2006, Chinese Security Regulation Commission (CSRC) placed private equity placements (PEPs) on the regulatory constraints for first time in the history of the Chinese capital market. PEPs are an important source of equity refinancing in China, and have accounted for 85% of the number of firms and 81% of the value of seasonal equity financing during the period from 2006 to 2009. Private equity issuance has important implications for various agents including investors, industry competitors, and issuing firms. It is important for

investors to know how PEPs affect the stock-price performance of issuing firms when making portfolio allocation decisions. Similarly, issuing firms need to understand how their private equity issuance affects the competitive environment, and how they can make their strategies to obtain an advantage over competitors. Chinese PEPs are highly regulated compared to other markets. Hence, findings of this study enhance the existing literature, knowledge of investor, issuing firms, and competitors in the context of the China. Private Equity Financing and Stock-price Performance of Competitor firms The competitive effects of PEPs have imperative and significant implications for a variety of agents, which comprised long-term and speculating investors, industrial competitors, and issuing firms. Issuing companies comprise of a relatively small portion of portfolio value; in this dissertation's sample, for example, 82. 5% (93% of our sample observations) of the total firms were constituted by existing and publicly traded firms, while only 17. 5% (7% of observations) were accounted by PEP firms. Therefore, this study is important for investors to recognize how PEPs affect the stock-price performance of non-PEP issuing (competitor) firms when make a decision on portfolio allocation. In the same way, when a firms wants to compete with PEP contenders need to know how the PE issuance impacts their competitive situation, and how they can be tactically responded to them.

Theoretical Background

In this section, we present all theoretical importance of the study in equity financing and stock-price performance in highly regulated Chinese market. Equity Financing Capacity and Stock-price Performance From the standpoint

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of neoclassical investment theories, the ability to raise equity capital provides the firm with financing flexibility and enables it to exploit any emerging profitable investment opportunities that will lead to future cash flow growth and increase shareholder wealth. Investors recognize the possibility of profitable investments and growth leading to higher expected returns. Thus, neoclassical investment theories predict a positive relation between capacity to raise equity and future returns. On the other hand, agency, signaling, and earnings-management explanations predict a negative relation between equity financing and returns. Agency conflicts between managers and shareholders may lead to the overinvestment problem, which is investing in unprofitable projects resulting in negative net present value (NPV) and loss of shareholder wealth (Jensen, 1986; Jensen and Meckling 1976)[50, 51]. When firms issue equity, the market recognizes this overinvestment problem by way of lower expected returns. The signaling hypothesis posits that firms issue equity when they are overvalued and market prices adjust downward subsequently leading to a negative relation between equity issuance and stock returns (Myers and Majluf, 1984; Loughran and Ritter, 1995; 1997; 2000; Ritter, 2003)[52-56]. Earnings management explanations argue that firms intending to issue equity opportunistically manage their earnings to alter financing proceeds in their favor (Cohen and Lys, 2006; Dechow, Richardson, and Sloan, 2008; Papanastasopoulos et al., 2011)[57-59]. When investors recognize earnings management, the price drops subsequently. The key implication for firms that have not yet issued equity but have the capacity to do so is that the market recognizes the propensity for these firms to issue equity and over-

invest, issue overvalued equity, or engage in earnings management activities leading to lower expected returns. Therefore, the capacity to issue equity capital will be negatively related with future stock returns (Fonseka et al., 2012)[18]. We contribute to the literature in a number of ways. We are examined the relationship between equity financing capacity and stock-price performance, which has received very little attention in the empirical finance literature. More importantly, our study is based on a unique setting where the capacity to issue equity to the public by firms listed in China is determined by the Chinese securities market regulations. The requirements for becoming eligible to raise external capital essentially creates two types of firms – those eligible to raise external capital and hence have external financial capability and those that are not eligible and hence have constrained external financing. We specifically examine whether the capacity to make rights and public offerings of equity is priced in the market in terms of future returns. Due to the tight controls and regulations related to access to public capital markets in China, only a portion of listed firms qualify to access public equity and debt markets in China. The capacity to raise external capital is an important intangible option available to the firm and could conceivably affect stock returns. We are able to enrich the existing literature on financing behavior and stock performance by showing how equity financing capacity is related to stock returns in a highly regulated emerging capital market. Private Equity Financing and Stock-price Performance of issuing firmsGou, Hotchkiss and Song (2011) find that private equity (PE)-backed firms show better stock-price and operating performance compared to the period before the PE investments. Prior literature related to

private equity in developed markets argues that firms select PEPs to avoid information asymmetry and adverse selection problems which are associated with market-based financing[60]. Chinese firms choose PEPs to acquire assets in order to obtain a listing, introduce strategic investors and raise funds. Studies on PEPs based on developed markets find evidence of positive announcement effects and positive post-issuing performance (Hertzel and Smith, 1993; Kato and Schallhem, 1993; Krishnamurty et al., 2005; Renneboog et al., 2007)[61-64]. The positive announcement effect is explained by monitoring effect, asymmetric information, managerial entrenchment, and investor over-optimism. Compared to other countries, Chinese PEPs have common features, such as non-public offering to specific targets and existence of certain lock-in periods. Further, they have few unique characteristics, such as various purchasing methods with cash or assets, regulation of lower limits on offering price, and different lock-in periods for different investors, and CSRC administrative regulations on PEP (Lu et al., 2011)[65]. In addition to regulations and above unique features, PEPs have been the predominant equity refinancing method by listed Chinese firms recently. We are able to enrich the existing literature on private financing behavior of PE issuing firms and Stock-price performance by showing how private equity financing is related to stock returns and abnormal stock returns in a highly regulated emerging capital market.

Private Equity Financing and Stock-price Performance of Competitor firms

We investigate whether CSRC's announcement of PEP arrangements generate a spill-over effect on the returns of competitor firms. Various studies indicate that the occurrence of major events or the disclosure of information affects a

company's stock returns (information content effect) as well as the stock price performance of its competitors (information transmission effect). In general, the information transmission effect of PEP announcements can be categorized into "contagion effects" and "competitive effects." The contagion effect suggests that the PEP announcement by one firm positively affects the future prospects of the competitor firms. Therefore, investors are likely to establish a positive association between the stock prices of the announcer and its industry rivals in the market. In contrast, competitive effect implies that the information in a PEP announcement changes original competitive situations and leads to wealth redistribution of competitor firms in the same industry. Therefore, a PEP announcement by one firm negatively affects competitor firms in the same industry. Very few studies have explored the information transmission effect of PEP announcements on the competitor firms even in developed markets. Hsu, Reed and Rocholl (2011) examine private equity investments in the US and Canada and find evidence of a negative effect that is consistent with competitive effect hypothesis[25]. Our paper is different from Hsu, Reed and Rocholl (2011)[25] due to following reasons; (1) Chinese stock market is a highly regulated market compared to the US and Canada, and a firm wishing to do a PEP in China has to satisfy the regulatory requirements and get clearance from CSRC, (2) Hsu, Reed and Rocholl (2011) study considered only large PE investments and only 11.24% of the sample represents PEP [86]. We study all PEPs and our sample includes 100% of PEPs, (3) Chinese PEP market is smaller than the market in the US and Canada, and PEP regulation has been introduced in more recently to China. China is the second major economy in the world, and

the Chinese stock market is the second biggest stock market in Asia. Hence, findings of this study are important for private equity issuing, competitor firms, investors and regulators in a different geographical context (4) we investigate regulator's PEP announcements effect on stock market performance of competitors' in the short- and the long-term, and Hsu, Reed and Rocholl (2011) study is limited to issuing firm's private equity investment announcement effect on stock price performance of competitors'[25]. According to the best of our knowledge, this is the first study, which examines / tests the information transmission effect of PEP announcements in China, and our findings add to the existing literature.

Research Motivations and Objectives

In this section, we present all our research motivations and main objectives, which are related to the studies included in this dissertation.

Equity Financing Capacity and Stock-price Performance

In this study, our objectives are limited to examine how equity financing capacity is related to future returns. A related and important issue is the factors such as earnings management that may explain the relationship between equity financing capacity and stock-price performance. The study of the earnings management explanation is beyond the scope of the study and we point out for a further research area. We will also investigate the subset of firms that in fact issued equity after obtaining regulatory approval. The subsets of firms include firms which got approval from the regulatory body and firms are actually raising financing through right offerings and public offerings.

Private Equity Financing and Stock-price Performance of Issuing firms

The study of private equity financing and stock-price performance of issuing firms has two objectives. First, we show regulator's various announcement effects of PEPs on issuing firms during the PEP process. We show that regulator's announcements of applying, withdrawal and rejection, approval and completions of PEPs affect private equity issuing firms. Our second goal is to test the information, ownership and agency hypothesis which are relevant to PEP in Chinese context and to explain the stock-price performance of issuing firms by examining the relation of cross-sectional differences in stock-price performance.

Private Equity Financing and Stock-price Performance of Competitor firms

The study of private equity financing and stock performance of competitor firms has two objectives. The first is to measure the stock-price performance of non-PEP firms around PEPs in their industries. If non-PEP firms can successfully compete against PEP firms, then we would expect the non-PEP (competitor) firms to perform better after the PEP event. We show announcement effects of PEPs on non-PEP firms in their respective industries. We show that application, withdrawal and rejection, approval announcements and completion of PEPs affect non-PEP firms in their industry. Our second objective is to investigate the stock-price performance of non-PEP firms by examining the cross-sectional differences in stock-price performance both in the short- and long-term.

Reasons for selecting China and Private Equity Placements

The institutional setup in China provides a rich and unique setting despite of the fact that there is a dearth of academic literature on the subject from Chinese market. Bo et al., (2011) noted that due to the transition nature of Chinese economy, Chinese stock markets functions differ from those of major mature market economies in that the markets, which are heavily intervened by the administration[20]. Another important distinction between the Chinese market and most developed markets including the US and Europe is that Chinese markets have much tied regulatory dependence on equity financing through capital market. In China, equity financing is identified as considered as a trouble free as it does not require the coupon payments and principal repayments associated with debt financing. So, firms want a Seasoned Equity Offering (SEO) regardless of their financial needs (Ni, et al., 2010)[21]. They also find that most listed Chinese firms were under-capitalized at their Initial Public Offering (IPO), and they prepared SEOs to archive a higher level of capitalization soon after the IPO issuance[21]. Hence, numbers of seasoned equity issues are larger than other emerging stock markets. The Chinese market rank number one in the world in terms of funds raise from capital market and it was second only to US market in terms of annual seasoned equity offerings. Therefore, the study of equity financing and stock-price performance is indispensable to investigate. More importantly, the study is based on a unique setting where the capacity to issue equity and debt to the public by firms listed in China is determined by the Chinese securities market regulations. The requirements for becoming eligible to raise external capital essentially create two types of

firms; those eligible to raise external capital and hence have external financial capability and those that are not eligible and hence have constrained external financing. We specifically examine whether the capacity to make rights and public offerings of equity is priced in the market in terms of future returns. The key implication for firms that have not yet issued equity but have the capacity to do so is that the market recognizes the propensity for these firms to issue equity. Hence, China provides unique setting for this kind of study about equity finance capacity and stock performance. There is a puzzle in announcement date and issuance date of seasoned equity offering in emerging markets, no consistent results. Most of studies show negative effects on stock-price performance, other studies show that positive reaction. But there is a gap in research on SEO announcements effect in China. Chinese SEOs firms' announcement effects differ from the other emerging markets due to announcements linked to the regulation process and there are number of announcement such as application for SEOs, approval, rejection, withdrawal and successful completion. In China, there are several announcement dates in order to measure the change in level of information asymmetry in these various dates. Different announcement dates provide us an opportunity to analyze the changes in behavior of Chinese investors throughout the SEOs issue process. One of the major reasons reported by US studies for diminishing price effect on SEOs announcement is due to information asymmetries between the managers and outside investors of firms. Due to long regulatory process, it is important to investigate whether informational asymmetries are persisting around the actual issuance dates. Chinese Seasoned equity

process provides unique setting for measuring the information asymmetry between different announcement dates by using the stock return. In recent years, private equity investors have turned to China for superior returns. International private equity funds have focused on the Chinese market and important international private equity investors continue to focus on opportunities in China (Bortnick and Forry, 2009)[19]. In 2006, the Chinese Security Regulatory Commission (CSRC) issued "the Measures for the Administration of the Issuance of Securities by Listed Companies" and placed PEPs on the regulatory constraints for first time in the Chinese capital market history. Private equity placement has dramatic increased number and the value during the period from 2006 to 2010. Hence, PEP was one of the most popular ways of equity refinancing in China during the sample period of this study. The new regulation of the private placement states the requirements for choosing private placements. The new regulation resulted in having fewer requirements for private placement than public placements. Hence, it is more beneficial to investigate private placement effects on stock performance of issuing firms in China. In addition to regulations and the unique features of Chinese PEP, PEPs have been the predominant equity refinancing method by listed Chinese firms recently. Hence, PEPs not only affect private equity issuing firms but also have an impact on competitor firms. Therefore, studying private equity placements is more important. Due to above reasons, we compelled to select China for this study and we give special attention on China's private equity placement affect stock-price performance of both issuing and competitor firms.

Descriptions of Research Methodology

In methodologically, theoretical analyses are conducted in combination with empirical approaches in this dissertation, where we mainly apply comparative analysis method to carry out the theoretical analysis. First, we place attention on theoretical analysis to develop our hypotheses.

Specifically, we intend to analyze the inherent mechanisms that how regulators' process affect equity financing and regulator's process impact on Chinese firm equity financing capacity, how these sources of equity financing capacity affect stock-price performance of the firms, and what role does institutional environment (including regulations) play in the context of China emerging economy. Based on data from Chinese listed companies during the period from 2000-2009, this dissertation conducts the empirical study to test our theoretical hypotheses on equity financing capacity and stock-price performance. In this study, equity financing capacity includes firms qualified for equity finance, applied for equity finance and firm issued particular types of equity. Second, we study most popular equity financing mechanism in recent past (i. e. Private Equity Placements) affect issuing and non-issuing (competitor) firms. Specifically, we intend to analyze the inherent mechanisms that how regulations of private equity financing and it regulator's process impact on stock performance of the issuing and competitor firms, and what role does institutional environment (including regulations) play in the context of Chinese emerging economy. Based on data from Chinese listed companies during 2006-2010, this dissertation conducts the empirical study to test our hypotheses on private equity financing and stock-price performance of both issuing and competitor firms.

Research Framework and Logics

Specifically, this dissertation will conduct the whole research following the framework and logics displayed in Error: Reference source not found below.

1) Introduction: In this chapter, based on both practical and theoretical background, this dissertation presents about its key research objectives along with the research methods and research significance. Then, it briefly introduces the definitions of several important concepts and theories, and it includes several potential research innovations in this dissertation. This is first Chapter of this dissertation. 2) Literature Review: According to the research issue in this dissertation, it briefly reviews the extant literature in Chinese institution characteristics and regulation on equity financing, relationship between equity financing capacity and stock-price performance, relationship between actual equity financing and market performance, and private equity financing and stock-price performance of both issuing and non-issuing firms in long- and short-terms, respectively. This is next Chapter of the dissertation. 3) Theoretical Analyses: On the basis of literature review, this dissertation builds theoretical models to analyze how equity financing capacity, actual equity financing, and private equity financing affect stock-price performance. We give special emphasize on private equity financing and stock-price performance of both issuing and competitor (non-issuing) firms in long- and short-terms. Based on institutional background, unique Chinese regulations on firm's financing, theories on financing, and previous literature, we develop our hypothesis to be test in this chapter. 4) Empirical Research Design: Based on the theoretical modeling results, related theories and testable hypothesis developed in the previous chapter, we introduces

sampling and data collection, empirical methodology, descriptive statistics of our main data in this chapter. This is fourth Chapter of this dissertation. 5) Empirical Results and Discussions: Corresponding to our hypotheses developed in the third chapter and empirical research design in the fourth chapter, we displays and discuss empirical results under three sections this chapter: empirical results on the relationship between equity financing capacity and stock-price performance, relationship between actual equity financing and stock-price performance, and private equity financing and stock-price performance of both issuing and non-issuing firms in long- and short-terms, respectively. Based on the theoretical and empirical results and findings obtained, we further discuss empirical findings for testing our hypotheses, theoretical contributions, and practical implications for improving firm financing, and stock-price performance in Chinese listed firms in regulated emerging economies. 6) Conclusions and Prospects: The final chapter of this dissertation concludes the main research work and findings, research innovations, research limitations and future research directions in this dissertation.

Research Innovations and Contributions

Overall, this dissertation has five main research innovations and several contributions as follows. First, we examine the relation between equity financing capacity and stock returns, which has received very little attention in the empirical finance literature. More importantly, our study is based on a unique setting where the capacity to issue equity and debt to the public by firms listed in China is determined by the Chinese securities market regulation. The requirements for becoming eligible to raise external capital

essentially creates two types of firms – those eligible to raise external capital and hence have external financial capability and those that are not eligible and hence have constrained external financing. We specifically examine whether the capacity to make rights and public offerings of equity is priced in the market in terms of future returns. The capacity to raise external capital is an important intangible option available to the firm and could conceivably affect stock returns. We will be able to enrich the existing literature on financing behavior and stock returns by showing how equity financing capacity is related to stock returns in a highly regulated emerging capital market. Second, we also investigate that how actual equity financing affects stock returns. We find that unqualified firms also got approval from Security Regulation Commission. Hence, we study effects of both qualified and unqualified firms which issued equity on stock return. Previous studies of equity financing and stock returns do not consider this aspect and they study firms as a pool sample. In our study, we separated this pool sample into two categories and investigate regulations effects. Hence, we will be able to enrich the existing literature on financing behavior and stock returns by showing how qualified and non-qualified equity issuing are related to stock returns in a highly regulated capital market. Third, we investigate whether announcements of the private equity placement application, withdrawal, rejection, approval, and completion affect returns of Private Equity issuing firms. We also examine the factors that impact the announcement effect in private equity placement events by examining the cross-sectional differences in stock-price performance. Chinese regulation process of equity finance includes application, approval and rejection/withdrawals and

completion of equity issue. According to security regulation commission, this process takes minimum of 2 months to maximum of 24 months for this approval process. Hence, this information comes to the market time to time. Only the announcing effect of the issuing firms' has investigated by the previous studies. They did not consider about other important events of Chinese equity finance regulation process. Therefore, our study is more comprehensive than previous studies. Hence, we will able to fill this research gap and enrich the existing literature on financing behavior and stock returns by revealing how important events of Chinese equity regulations affect stock-price performance. Fourth, previous Chinese private equity financing studies does not cover the long-run stock-performance of private equity issuing and competitor firms and don't observed that spillover effect relevant to PEP in China. Compared to other countries, Chinese PEPs have common features, such as non-public offering to specific targets and existence of certain lock-in periods. Further, they have few unique characteristics, such as various purchasing methods with cash or assets, regulation of lower limits on offering price, and different lock-in periods for different investors, and CSRC administrative regulations on PEP (Lu et al., 2011)[65]. Findings of this study will enhance the literature on long-run stock-price performance of private equity financing firms in China. Fifth, private equity offering become most popular re-equity financing mechanism in listed Chinese firms. Hence, private equity offering can affect non-issuing (competitor) firms' stock-price performance. The first step is to measure the stock-price performance of non-PEP firms around PEPs in their industries. If non-PEP firms can successfully compete against PEP firms, then we would

expect the non-PEP firms to perform better after the PEP event. We present announcement effects of PEPs on non-PEP firms in their respective industries. We will reveal the effects of application, withdrawal and rejection, approval announcements and completion of PEPs events affect non-PEP (competitor) firms in the same industry. We also investigate the market performance of non-PEP (competitor) firms by examining the cross-sectional differences in stock-price performance both in the short- and long-terms. According to best of our knowledge, there is no study about effect of private equity offering on non-issuing (competitor) firms in Chinese context. This study is innovative due to inclusive of institutional backgrounds and regulation incorporated. Further, we will able to enrich the existing literature on private equity financing behavior and market performance of non-issuing (competitor) firms in Chinese context by showing how private equity financing process is related to stock returns of non-issuing (competitor) firms in a highly regulated emerging capital market. Literature ReviewDespite a growing corporate finance literature on seasoned equity offerings (SEOs), there is a surprising lack of evidence on how equity financing capacity affect stock-price performance and how different mechanism of SEOs announcements affect stock-price performance of issuing and competitor firms in China. We linked these announcements to the regulator process in China. This is especially true for the highly regulated stock markets outside the US, where SEOs are conducted primarily as rights offerings (ROs), public offering or private equity placements (Cronqvist and Nilsson, 2005)[66]. According to the research issue in this dissertation, we will briefly review extant related literature in Chinese capital market, Chinese Seasoned equity

offering mechanism, equity financing capacity and stock-price performance, actual equity financing and stock-price performance of equity issuing and competitor (non-issuing) firms and theories on equity financing and stock-price performance respectively.

Chinese Capital Market and its Developments

The history of stock trading activity were commenced in the 1920s in China. However, stock trading was banned after World War II and it was recommence in the early 1980s. The new Chinese stock markets were inceptioned into being impulsively by some grass-root efforts rather than supported by the government. However, the development of stock market have been occurred at an amazing speed (Liangyi and Tse, 2006)[67]. The capital market of are recently established compared to other developed and emerging markets and China commenced to reform its economy in the early 1980s. The government wanted to improve the efficiency of its State-Owned Enterprises (SOEs), as it received annual funding from the government's budget allocations, The government is intend to financing SOEs through developed capital market (Ni et al. 2010)[21]. In late 1980s, Preparation was under taken to start an official stock exchange to trade shares of the new joint-stock companies. But, private ownership and privatization remained as a political taboo (Chen, 2003; Chen and Xiong, 2001)[68, 69]. In particular, no instituion want to took the responsiblity for the loss of state-owned enterprises. As a political compromise, the reformers proposed to have several classes of shares such as state shares, legal-person shares, and floating common shares. legal-person shares only own by legal-person institutions and corporations. There are two types of floating common shares

namely " A-shares" which for domestic citizens only and " B-shares" for foreign investors only. Further, there are another two types of nonfloating shares: state shares and legal-person shares would not be publicly tradable as per security regulation. Hence, state ownership is not loss its right (Chen, 2003)[68, 69]. However, regardless types of shares, all share-holders are entitled to the same cash-flow and voting rights. At present, one third of its shares in a state-owned company comprises about each category of state, legal person, and floating common shares (Chen, 2003; Chen and Xiong, 2001)[68, 69]. Chen (2003) point out that most legal-persons and corporations are held by state-owned institutions or provincial or central state. Hence, approximately two thirds of most corporations' stocks are controlled or held by the state directly or indirectly. The main constraint behind for the difficulties in private securities litigation is state ownership structure, which has been identified as granting damage awards in private litigation would amount to the loss of state assets and it puts the court in a conflicted situation[68]. Chen (2003) also points out that the income through labor is rightly acceptable according to the traditional communist view, although Stock Exchanges were opened in early 1990. Until November 2002, this official line on rightful income remained in the Communist Party charter. The 16th Party Congress was revolutionized the contract. It is officially acknowledged and accepted the income can earn from monetary capital, intellectual capital and managerial capital[68]. However, some members of Communist Party did not support to buy or trade stocks officially. Chen (2003) noted that this ideology seems contradictory to the notion of shareholder rights and the protection of shareholders, which has been increased

the time for implementation of the Securities Law and the Company Law in China [68]. According to the Chen (2003) and Johnson et al. (2000) another common practice done by Chinese public companies is known “ tunneling,”[35, 68]. It has been defined in a different context by Johnson, La Porta, Lopez de Silanes, and Shleifer (2000)[70], in this case, controlling or majority shareholders engage in related party transactions with the listed firm, usually with the latter buying worthless assets from the former at unfairly high prices or with the latter lending to the former at favorable rates. Chen (2003) noted that the tunneling of shareholder assets is widespread and has led to calls for regulations and tighter enforcement by the CSRC[68]. These developments and background kept in the 1990s and even early 2000s, there is not enough ideological acceptance of private ownership and stock trading, as there was not sufficient protection of property rights (Chen, 2003)[68]. Especially in the early years, China did not have a proper legal infrastructure to facilitate capital market development from inception to early 2000s (Chen, 2003)[68]. However, consistent with the “ crash-then-law” hypothesis of Coffee (2001)[68], China commenced its capital market without a unambiguous plan of what institutional framework would be required for a stock market, but number of investors has increased tremendously, a powerful constituency was developing, which led to a sequence of legal development. The CSRC and other government agencies controls are placed every step of the way in the overall market development process and the firm’s pre-IPO preparation as well as post-IPO operations. The stock exchanges are owned by the state and government-appointed officials are responsible for the management, while the securities firms are

state-owned or controlled by the government directly or indirectly (Chen, 2003)[68]. However, as there was no security law until July, 1999; In 1993, administrative regulations introduced in order to overcome the constraints associated to the stock market operations. The Provisional Rules on Stock Issuance and Trading were issued by CSRC in 1993 and the CSRC forbidden various troubles practices and provided for civil compensation for those who were financially damaged due to the various troubles malpractices (Hutchens, 2003)[71]. However, the court was not willing to accept for private securities legal action., Hence, administrative requirements would not significantly enough for private investors. punishments can only be enforced either administratively by the CSRC or through criminal litigation of the Public Security. Chen (2003) and Walter and Howie (2003) stated that the administrator punishments against wrongdoer of securities rules commenced in 1996, which same-time with the last segment of the 3-year long bear market, which started on in mid-1993. During the bear market, many individual investors were underwent losses, and these losses caused them to ways from the market untill recovery of the market. The investors looked for advices from the professionals. These professional and academic commentators were calling for better enforcement of market rules and ultimate objective was a “ better” market[68, 72]. Chen (2003) pointed out that the CSRC had to take more aggressive administrative actions in 1996 and onward due to the public pressure. Thus, it is the first bear market, together with the fast-growing investor constituency, that encourages a significant public enforcement. This is referred to as “ crash then administrative enforcement”[68]. The stock markets in China were

established and developed in order to raise capital to finance SOEs' investments, the Chinese government faced great difficulties in keep the trade-off between the issue volume and issue price. On one hand, the government desires to sell more shares in order to finance the investment in SOEs. On the other hand, the government is cautious to sell more shares because of the concern that too large an offering leads stock prices to fall, which in turn could decrease the interest of the investors and catch the attention of political opposition to sell state-owned shares at a discount. Hence, the Chinese Securities Regulatory Commission (CSRC) sets strict regulation on qualification for equity issues and regulates the equity issuing process (Ni, et al., 2010)[21]. Chinese SEOs are heavily exposed to security administrative regulations. Firm has to qualify eligibility requirements for applying SEOs. The main pre-request, firm has to satisfy profitability requirements to issue seasoned equity offerings (SEO). The minimum condition for an SEO as imposed by CSRC regulations are undergone various changes over the years: the ROE requirement of the firm was to be (1) positive in the most recent 2 years, a regulation as of 1993; (2) above 10% ROE stand for the recent 3 years' average, as the regulation of 1994; (3) above 10% ROE in each of the recent 3 years, in the regulation of 1996; (4) above 10% ROE stand for the recent 3 years' average, but at least 6% ROE for each of the consecutive 3 years, in the regulation of 1999; and (5) above 6% ROE stand for some weighted average for the consecutive 3 years, in the regulation of 2001. These four regulatory changes have each time caused listed companies to adapt their accounting manipulation methods. Disgracefully, many listed Chinese companies have exceed their profitability

just slightly above 0% of ROE; then, in between 1994 and 1999 period, more than 50% of total listed Chinese firms were slightly above 10% but below 12% of ROE; but, in specifically, since 2001, most of the listed Chinese firms had maintained an ROE between 6% and 8%. These studies present the strongest evidence of market wide earnings manipulation, implying that investors have been systematically defrauded (Chen, 2003; Chen and Yuan, 2004; Ni, et al., 2010)[21, 68, 73]. Most listed Chinese companies were under-capitalized at their initial listing; they prepared an SEO to reach a higher level of capitalization soon after the IPO issuance. Managers of these companies view equity financing as fundamentally trouble free, as it does not need the coupon payments and principal repayments connected with debt financing (Ni, et al., 2010)[73]. They want a SEO despite of their financial needs. Therefore, to protect the shareholders' interests, the CSRC issued a series of regulations on the qualification for an SEO. The most rigid regulation is the minimum ROE requirement, which developed as follows: in September 1994, a firm's 3-year average ROE had to be no less than 10%. Another unique feature of the Chinese capital market is that the corporate bond market is very small and undeveloped. For example, while China's bond market was only 27% of GDP in 2006, only 6% of bonds, including commercial paper, were issued by nonfinancial firms. The corporate bond market provides only 1.4% of the total financial needs of firms in China (Ni, et al., 2010)[73]. Hence, we forced to study equity financing and stock-price performance.