

1. Corporate finance in China

1.1 Introduction

Over the past three decades, China's economy has developed rapidly, and its GDP has increased by 185 times between 1978 and 2015. However, despite such soaring economic growth, most existing studies focus on the topics well examined in developed markets. As China has undergone substantial markets/institutions development and reforms in recent years, there is still much to be learned about the firm behaviors, capital market functioning and information dissemination, both in theory and in practices.

This special issue of *China Finance Review International* attempts to investigate various topics of corporate finance in the setting of China. In doing so, we seek to improve our understanding on the firm's behaviors, decisions and economic consequence under the China's capital markets, which will provide significant academic contributions and policy implications. Specifically, topics in this special issue include: first, a comprehensive survey of reverse mergers (RMs), a very prevalent phenomenon in China; second, the effects of firm's earnings management on the trades of different investors prior to earnings announcements, which is based on unique account-level data and provides new insight on the understanding of institutional investors behaviors in the emerging market; third, the improvement of top managers' overseas experiences on firms' foreign customers, which offer supportive evidence to the "brain gain" theory; fourth, the catering behaviors of China's listed firm in corporate governance from the perspective of minority shareholder pressure; fifth, investigation on the impacts of equity market valuation and government intervention on the R&D investments, which suggests that the functional borders of markets and government should be reasonably defined to enable markets to play a decisive role in resource allocation and enhance corporate innovation; and sixth, the final paper examines how the housing price affects firm financing and finds that regions with higher housing price are associated with the high level of mortgage, offering policy implication to regulators in the housing market.

2. Overview of the contributions

Our first paper, by Xin, Li and Wong, provides us with a comprehensive introduction of RMs conducted in the China's stock market. By summarizing the regulatory system, surveying the literature on RMs and analyzing major characteristics of 161 RM cases from 2006 to 2016 in China's stock market, the authors claim that private companies that go public via RMs may have superior asset quality and demonstrate good accounting and stock price performance after listing, which is different from the studies on the quality of RMs in other countries. The authors indicate that the superior performance of RMs in the China's stock market can be originated from the interplay of market forces and regulatory oversight, suggesting that China's regulator's pragmatic and flexible approach is vital in formulating regulatory policies that respond to the changing macroeconomic environment and financial markets.

The second paper, by Liu, investigates if earnings management affects the trades of different investors prior to earnings announcements. Having obtained direct evidence from the account-level trading data set in the China's stock market, the author demonstrates that institutional investors, particularly active ones, tend to sell (buy) stocks before negative (positive) earnings surprises. Also, institutional investors buy stocks intensively with the lowest earnings management and the highest earnings surprises, and the trading patterns are primarily driven by active institutions. Yet, no significant trading pattern is observed on



the stocks with negative earnings surprises. The author claims that the causality of the above findings still holds after a natural experiment was applied to address endogeneity. In performing these analyses, the paper provides clear evidence by emphasizing the importance of earnings management in the formulation of investor decisions.

Researching into the effect of returnee managers on China's firms' performances is the basis of our third paper by Dai. By analyzing the data set of managers' foreign experiences and firms' principal customers, the author comes to the conclusions that returnee managers can increase the probability of firm's gaining of overseas customers and proportion of overseas sales, and they also facilitate firms to conduct international M&A, adopt international Big 4 auditors and list overseas. Apart from that, the individualistic culture and overseas working experience enable returnee executives to help firms perform well when entering the familiar overseas market. Serving as the first to examine the role of returnee managers in an emerging economy on firms' probability of gaining overseas customers and expanding overseas, the investigation facilitates firms to increase their success in overseas markets via choosing the "right" returnees.

The fourth contribution by Kong tests a catering theory from the perspective of minority shareholder participation (MSP) in corporate governance. The measure of MSP is constructed through using a novel online voting data set in China's stock market. To address endogeneity, the author introduces propensity score matching, difference-in-difference methods, instrumental variables and Heckman estimation in regressing the earnings management on MSP. The findings demonstrate that the role MSP plays in external monitoring is limited, yet the high MSP levels stimulate the firms to manage earnings more actively. Additionally, information asymmetry, proposals' importance, managerial incentives, as well as CEO financial expertise can significantly affect firms' catering behaviors. This investigation is of particular importance since it provides empirical evidences for government regulators who are concerned about the costs and benefits of granting minority shareholders direct control over corporate decisions.

The penultimate paper, by Xu, He and Xu, empirically studies the impact of equity market valuation and government intervention on the R&D investments of listed companies in China and their relationship. By collecting the R&D database from 2007 to 2015, the authors constructed a sample of firm-year observations and utilized the methods of pooled OLS regressions, before coming to the conclusion that market valuation may enhance corporate R&D investments, while the impact of government on R&D investments remains insignificant. Nevertheless, government intervention may weaken the promotion of market mechanism to corporate R&D investment, especially for non-state-owned firms and non-regulated industries. The investigation suggests that the functional borders of markets and government should be reasonably defined, which enables markets to play a decisive role in resource allocation, and thus improving corporate innovation and national innovation.

Our final paper, by Li, explores the impact of the housing price increase on enterprise financing. Based on the matched data of listed companies ranging from 2001 to 2015 and the housing prices, the author comes up with empirical results, claiming that the mortgage effect does exist; for example, regions with higher housing price are associated with the high level of mortgage. The author further analyzes the heterogeneity of the above effect, in which the empirical results suggest that the influence of mortgage effect is more significant in places with the high level of financial development and in SOE enterprises, indicating that mortgage effect should be considered when regulating housing market so as to improve the financing capabilities of companies.

3. Conclusions

The contributions in this special issue have addressed a number of issues, with particular focus on the unique characteristics of China's capital market settings. Overall, all six papers

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included in this issue present various evidence of corporate finance from different aspects. We believe that the findings reported in these papers have implications for policy makers and corporate sector in emerging markets, which also provide complementary and out-of-sample evidence to the related studies in developed markets. We are also aware that the topics covered in this special issue only account for a tiny part of the potential important topics in China's capital markets. We thus hope our research could inspire more related studies based on the setting of China.

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