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THE DIFFERENCE IN INVESTMENT BEHAVIOR BETWEEN LISTED AND UNLISTED FIRMS IN CHINA

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ABSTRACT

Using a panel database of the listed and unlisted firms in China, we compare the differences of investment behavior between listed and unlisted firms in China, matched by size and industry, from 1998 to 2007. In China, state-owned enterprises (SOEs) account for a significant proportion of listed firms, both in number and in gross value of industrial output. In order to capture the impact of ownership type on the investment behavior between listed and unlisted firms, we further categorize the sample firms into SOEs and non-SOEs. In addition, in China some industries are known as "protected industries", including petrochemicals, energy, raw materials, which are dominated by large monopolies under direct supervision from the State Council of the PRC. Receiving the relatively favorable treatment in accessing outside capital, corporate managers in protected industries may invest differently compared with others. Hence, we further categorize the sample firms into protected industry and unprotected industry. In order to measure the influence of managerial myopia to investment, we use the earning response coefficient (ERC) as the proxy for it and classify the firms into "high-ERC and low-ERC" industries, respectively.

The results of our regressions document that listed firms invest more than unlisted firms, and firms in protected industries invest more than firms in unprotected industries. Unlisted firms have higher sensitivity of investment to investment opportunities and lower sensitivity of investment to cash flow than listed firms. Firms in unprotected industries have lower sensitivity of investment to investment opportunities and lower sensitivity of investment to cash flow than firms in protected industries. Non-SOEs have higher sensitivity of investment to investment opportunities and lower sensitivity of investment to cash flow than SOEs.

The results of regressions on the two-way classification document that listed firms in protected industries have higher sensitivity of investment to investment opportunities but more severe financial constraints than other firms. In addition, unlisted non-SOEs have higher sensitivity of investment to investment opportunities, and lower investment-cash flow sensitivities than other firms. The difference of investment efficiency between unlisted and listed firms becomes larger in higher ERC industries. We attribute our findings to the agency problem in listed firms, namely the managerial myopia and "empire building" behavior of their managers, and the policy-driven investments in protected firms and SOEs, the political incentives of the SOEs' managers, and the government support for the protected industries.

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