

Choice of Corporate Debt in China: The Role of State Ownership

Pierre Pessarossi

University of Strasbourg, LARGE Research Center
Strasbourg, France

Laurent Weill

University of Strasbourg, EM Strasbourg Business School, LARGE Research Center
Strasbourg, France

In spite of its impressive growth, China still owns an underdeveloped financial system with notably a weak corporate bond market. In terms of modernization of the Chinese financial system, corporate bond market development is a major issue as a well-functioning corporate bond market can provide a better allocation of capital in the economy.

Our objective in this paper is to analyse the determinants of the choice for a Chinese firm to issue a bond. The main alternative financial instrument to a bond is a syndicated loan. Therefore, we focus on the choice of issuing a bond rather than asking for a syndicated loan. Three theories have been provided to explain the choice between public and private debt issuance in the literature which rely on flotation costs, asymmetries of information, and costs of debt liquidation and renegotiation.

Our first contribution is to analyse the relevance of these theories to understand the choice of corporate debt in China. As the corporate bond market development has been impeded for a long time, it is still unclear to what extent corporations choose their debt markets on economic grounds. It is therefore of interest to determine if the choice of debt is mainly driven by political preference or if financial factors play a determinant role as in other countries.

Our second contribution is to take into account a key characteristic of this country: the influence of the State in the economy. Thus, we consider a fourth hypothesis in our analysis – central government ownership – which can influence approval required to issue a corporate bond. As, historically, central state-owned enterprises have been favoured in their access to the corporate bond market we check whether state ownership at the central level plays a role on the choice of debt financing. As this influence of state regulatory bodies in giving approval has been driven by the will to avoid corporate bond defaults on the market, we expect central state-owned firms that present less asymmetries of information for the regulators to be particularly favoured in the approval process.

We test these four theories of corporate financing choices on a dataset of 220 listed firms over the period 2006-2010. We employ logit models with random effects at the firm level to explain corporate financing choice. We include variables to take into account the four theories. The estimations are then intended to reveal the extent to which corporate debt choices are politically or economically driven. The conclusions are that financial considerations play a minor role in corporate debt decisions in China compared to elsewhere, while state ownership remains a key determinant of choice of financing.

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