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The financing and growth of firms in China and India: Evidence from capital markets☆

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A B S T R A C T

This paper studies the extent to which firms in China and India use capital markets to obtain financing and grow. Using new data on domestic and international capital raising and firm performance, it finds that financial market activity has expanded less since the 1990s than aggregate figures suggest. Relatively few firms raise capital and even fewer attract most of the financing. Moreover, firms that issue equity or bonds are different and behave differently from other publicly listed firms. Among other things, they are typically larger and grow faster. The differences between users and nonusers exist before the capital raising, are associated with the probability of raising capital, and become more pronounced afterward. The size distribution of issuing firms shifts more over time than the distribution of those that do not issue, suggesting little convergence in size among listed firms.

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1. Introduction

One of the most notable developments in the global economy of the past 30 years is the rise of China and India as world economic powers.[1] Though they still lag in many respects, their financial systems have developed rapidly.[2] After significant reforms and financial liberalization initiated in the early 1990s, their financial systems have become much deeper. For example, stock market capitalization increased from 4 percent of GDP in China and 22 percent in India in 1992 to 80 and 95 percent of GDP in 2010, respectively. By 2010, 2063 firms were listed on China's stock market and 4987 on India's. Moreover, both countries' financial systems have shifted from a mostly bank-based model to one where capital (equity and bond) markets have become more important. Capital markets expanded from 11 percent of the financial system in China and 57 percent in India in 1990–1994 to 53 and 65 percent in 2005–2010.[3] In addition, nonbank institutional investors have started to play a more central role, channeling domestic savings and fostering the growth in capital markets.[4]

This paper studies how much firms in China and India have used this expansion in capital markets to obtain financing and grow. First, it examines the expansion in equity and bond markets over the past two decades and studies whether the growth has meant widespread use of these markets by the financial and nonfinancial private sector. Because financial liberalization enables transactions to occur both domestically and abroad, the paper evaluates the use of domestic and foreign markets. Second, it characterizes which types of firms obtain financing from capital markets. Third, it analyzes whether capital market financing is associated with changes in firm performance. Finally, the paper studies how changes in firm size and growth affect the size distribution of listed firms.

To conduct the analysis, a comprehensive dataset was assembled on domestic and international capital raising and performance by Chinese and Indian firms. The focus is on the recurrent use of equity and bond markets among publicly listed firms after their initial public offerings (IPOs).[5] The dataset was constructed using transaction-level information on issues of common and preferred equity between 1990 and 2011 and on corporate bond issues between 2000 and 2011 using Thomson Reuters Security Data Corporation (SDC) Platinum database. These data were then matched with Bureau van Dijk Orbis data on balance sheet information for publicly listed companies between 2003 and 2011.[6] The matched data cover 2458 firms in China and 4305 in India, of which 1915 and 3428 firms, respectively, did not have any equity or bond issues between 2003 and 2011.

Two main features emerge from the analysis. First, the results suggest that the expansion of financing to the private sector in China and India has been much more limited than aggregate data suggest. Though capital raising in equity and bond markets expanded substantially in 2005–2010, it remained small as a percentage of GDP. Moreover, this expansion was not associated with widespread use of capital markets by firms. For example, the amount of capital raised through equity issues in domestic markets doubled in China (from 0.5 to 1.0 percent of GDP a year) between 2000–2004 and 2005–2010, but the number of firms using these markets increased only 20 percent (from 87 to 105 of 1621 listed firms).

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[1] China grew by more than 20 times in real terms between its economic liberalization in 1978 and 2011, while India expanded 6.5 times. China's GDP per capita increased more than sixfold between 1990 and 2009, while India's more than doubled.

[2] See Allen et al. (2005, 2007), Eichengreen and Luengnaruemitchai (2006), Neftci and Menager-Xu (2007), Chan et al. (2007), Lane and Schmukler (2007), Shah et al. (2008), Chakrabarti and De (2010), and Patnaik and Shah (2011a, b).

[3] Here a country's financial system is considered the sum of the assets of the banking system, stock market capitalization, and bond market capitalization.

[4] This pattern is consistent with other countries, where banks and capital markets become more developed as economies grow and capital markets develop more rapidly than banks. See Luintel et al. (2008), Demirguc-Kunt et al. (2013), and references therein.

[5] The focus on publicly listed firms provides a more homogeneous group of firms that, compared with unlisted firms, are large, have met the costly listing requirements, and are formal corporations that can raise capital.

[6] The Thomson Reuters Worldscope database was also used to obtain information on capital expenditures and to check the robustness of the results.

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