Listing on the Shenzhen Stock Exchange: Behavioural Finance Implications

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Abstract

This paper examines the behavioural implications of listing on the Shenzhen stock exchange (SZSE). In contrast to the Shanghai stock exchange (SHSE), where most initial public offerings emanate from former state enterprises, the majority of SZSE IPO's applications come from successful high-tech private companies seeking wider share ownership. The contrast in subsequent price volatility on the two exchanges suggests a reason as to why after a short lag they can differ so markedly. The authors propose that behavioural finance issues can be expected to exacerbate share market valuations beyond that which can be explained by traditional two-factor capital asset pricing modelling alone. It is suggested here that some of this 'irrational' divergence can be attributed to the behavioural dynamics of recent and unexpected news impacting share values differentially depending on the temporal dimension involved. Evidence for this claim is supported by field interviews with top management of five recently floated companies in observing their reactions to unexpected news pertaining to corporate governance, investor relations and the new institutional environment they now face in having successfully floated.

Key words: Shenzhen Stock Exchange; China stock markets; Listing effects; Corporate governance; Investor relations; Institutional environment; China market efficiency

INTRODUCTION

Previous research studying corporate governance issues in China has mainly focused on listed state owned enterprises on the Shanghai stock exchange (SHSE) (see for example Qu 2003; Wang, Xu & Zhu 2004; and Zhang, Zhang & Yang 2004). However, most emerging listed companies on the Shenzhen stock exchange (SZSE) are generated from private enterprises, rather than from former government entities.

SHSE is significantly different from SZSE, especially in regard to their listing rules. The difference is somewhat akin to the difference between the NYSE and NASDAQ in the USA. Listing in SHSE can be almost regarded as synonymous as emerging from state ownership of the equity of a corporation,

while an application to be listed in SZSE usually means an initial public placement for a company that would otherwise remain privately owned.

Apart from Hong Kong, which is now part of a special economic zone, the two exchanges have an almost exclusive dominance of the mainland Chinese securities markets. While the SHSE began trading in securities in the 1860s (falling into disrepair in the post-war period and re-established in 1990), SZSE was established on 1 December, 1990. Both are self-regulated legal entities under the supervision of China Securities Regulatory Commission. Functions include providing a facility for securities trading, formulating operational rules, arranging securities listing, organizing and supervising securities trading, offering membership supervision and oversight of listed companies, as well as managing and publicizing market information.

SZSE is committed to developing China's multi-tier capital market system. The stock exchange not only gives full support to the development of small and medium businesses but also to the implementation of a national strategy for independent innovation. A Small and Medium Enterprises (SME) board was launched in May 2004, and another submarket called the ChiNext Growth Enterprise Market (GEM) was inaugurated five years later in October 2009. Thus SZSE provides framework for a multi-tier capital market system by coordinating the combination of the main board, SME and GEM. On 30 September 2011, SME had 618 listed companies; ChiNext 267.

While issues pertaining to corporate governance, investor relations and the environment impact company policies in both exchanges, our immediate focus will be on environmental influences. These areas have already been studied from several angles, often using a quantitative approach (Xu & Wang, 1999; Bai, Clarke 2003; Xiaodong & Xiaoxue 2003; Liu, Lu & Song 2004; and Chen, Firth, Gao & Rui, 2006), but our bias is towards their behavioural impact. Both corporate governance and investor relations in China have been studied in some detail (Xiao, Li, Gu & Wang 2007). Significantly for our research, since 2006 under the listing rules of the SZSE, it has become mandatory for all companies to have an explicit investor relations unit (Xiao, Li, Gu & Wang, 2007). By contrast, relatively little research has been devoted into the less explicit effect of the impact of subtle government changes in corporations law on the environment in jurisdictions covering IPOs. These changes have nevertheless major repercussion on recently listed companies, with a proportionately larger impact on those with higher operating risk, as will be explained below.

Seeking an initial public offering on SZSE entails facing potentially more unique obstacles than on other exchanges. These stem not only from identifying the business and financial risk appropriate to each company, but also from behavioural issues associated with the degree of disclosure now expected by exposing the company to an open market. An expanded market for a share of common stock presents a brave new world for a newcomer, and the market can be ruthlessly efficient in ferreting out the intrinsic value of that stock.

Nevertheless, while SZSE is an efficient market, it is not necessarily strongly so. In fact, it falls considerably behind its larger cousin because of these behavioural finance obstacles. These are additional to the business and financial structure characteristics typical of high technology companies. Behavioural finance issues unique to a SZSE listing can be identified as (1) stringent new standards of fiduciary duty expected of the agents to the owners, *ie* the governance issue; (2) to an imperative demand for maintaining higher standard of media interaction with analyst, *ie* investor relations; and (3) to a heightened sensitivity to political and government intervention, *ie* the dynamic environment issue.

These issues comprise obstacles comprising a behavioural finance effect first explicitly identified by Shiller (2000) and Thaler (1993, 1994, 2005), among many others. These issues were identified by the managers interviewed in our study, although they may not have been properly articulated and their importance only vaguely assessed. Nevertheless, the topics identified included corporate governance or agency issues; proper handling of investor relations; and an increased exposure to the political and social environment were usually referred to. It should be noted at the outset the cultural milieu in China differs from the more open climate of the West, so the responses received could have been more guarded. This unspoken psychological momentum of clashing authoritarian *vs* free market cultures would have constrained full and open discourse, an observation noted by other researchers (*eg* Balsara, Chen & Lin 2007).

The next section justifies the methodology used in our research. This is followed by a discussion of our results obtained in the management interviews, embracing three tentative propositions relating to corporate governance, investor relations and the institutional context. The conclusion and suggestion for further research gives a retrospective summary of the central tenet of this paper, and offers suggestions for pursuing this line of argument further.

METHODOLOGY

Five companies recently listed on the main and subsidiary boards of the SZSE were approached to be studied. The fieldwork itself took the form of a series of specific and open-ended questions adapted from a battery of tests recently used by other researchers. The interview question list is reproduced in full in the appendix.

The management interview was designed to elicit the evidence of a guide as to what the lag may allude from an inductive research perspective. The ethical standing of the management interviews was certified by the University and conducted in China over an eight-week period in May and June 2011. Promising companies were approached, initially semi-randomly, and then refined as a stratified sample on the basis of a set of criteria, viz.: (1) identifying transition recently to a successful listing to the SZSE; (2) a low operating beta company which derives most of its share value from a positive and steady net cash flow; (3) a rapid-growth high tech company which derived most of its share value from growth potential; and (4) a willingness to be surveyed. No executives who participated wished to be identified by their real name. So prescribed, the company, nature of their business, the position held by the interviewee and their gender is listed in table 1.

Table 1: List of Companies

Interviewee Name	*Gender*	*Designation(s)*	*Company*	*Main Business*	*SZSE Board Category*
Yang	Female	Securities Consultant	KK	Candle and glass manufacture	SME
Cui	Male	General Manager & Chief Financial Officer			
Huang	Male	Deputy General Manager & Secretary of the Board			
Tai	Male	Deputy General Manager & Chief Financial Officer	OMH	Development, production and distribution of appliances parts	SME
Liu	Male	Deputy General Manager & Secretary General Director	DGT	Production and design of cubicle-type substations	ChiNext market
Zheng	Male	Securities Consultant & Chairman of Board of Supervisor	CNM	R&D of industrial information technology	SME
Bin	Male	Chief Financial Officer & Secretary of the Board & Deputy General Manager	PHQ	production, marketing and R&D of intravenous solution	ChiNext market

Information content provided by the interviewees may have incurred loss because of the manner by which interview data was acquired. As company policies did not permit real-time voice recordings, responses were initially typed on a laptop computer as the interview progressed. The interviews varied in length, from one hour to almost half a day in one case. Written transcripts of responses were given to interviewees to ensure authenticity, signifying agreement by both interviewer and interviewee that the record of what had transpired were largely accurate, if perhaps not an exact verbatim rendition of what indeed was said and how it was said. Expression inflections and body language are therefore missing and must be inferred. Also, as the English translation of the Mandarin transcript took place some weeks later in Australia, there may also be some information loss in the translation process and/or interviewer recollections. The original transcriptions are available from the authors.

The question list distributed to executives of the companies agreeing to being interviewed was designed to elicit some meaningful discourse as to the 'immediacy effect' of listing. The question categories followed Klapper & Love (2004) groupings, categorised into six groups. These questions relating to personal background, disciplines, transparency and responsibilities covered the aspects of corporate governance. Questions also related to company social awareness and the institutional environment, including queries soliciting information about the complexity of the market and if government regulations were onerous or not. Other questions were more direct, including relationships with security analysts and investors. Some categories were revised to suit peculiarities unique to China. The interviewer kept silent for most of the time, not elaborating on the written script in order to encourage open-ended, cathartic responses.

CORPORATE GOVERNANCE

The first group of questions sought some company information on corporate governance, and from a research point of view are best seen from the perspective of the seminal contributions of Shefrin (2001), Morck (2004), and Klapper & Love (2004).

Two major behavioural influences affected company policy according to Shefrin (2001). The first impacted issues internal to the firm, such as behavioural costs, including the loss which results from

cognitive errors, emotional factors. The other impediment is external to the firm, which may be caused by behavioural imperfections by analysts and investors. He examined two cases to elaborate the impact of this proposition on the development of companies, using a novel technique known as 'primary document analysis,' in addition to interviews. Since office dysfunctional groups are prone to amplifying individual biases, managers often counteracted behavioural errors by the same method, but such knee-jerk reaction may not always be the most efficacious in solving such problems.

Morck (2004) and Mork & Yeung (2010) similarly identified unique behavioural problems of corporate governance in companies located in undeveloped countries. Reflexive subservience and cognitive dissonance would typically reverberate to amplify nascent problems. Restitution would be difficult in such cases, as the actors would lack sufficient training, thus embedding dysfunctional behaviours in the organisation. From a research perspective, although the predominant economic paradigm holds that 'firms maximize value and people maximizing utility,' the reality is that firms are nevertheless run by humans with all their foibles. So if company directors of the firms are inefficient in performing their fiduciary duties, then production and capital allocation decisions could be initially distorted, and moreover remain so, perhaps even deteriorating. In a situation of rapid company development, dysfunctional behaviours mitigates against what would otherwise enhance share value. This causes investor confusion and generates uncertainty. It might also signal to the marketplace `irrational' behaviour, all of which would have a negative impact, out of all proportion to the origin of the problem. As an antidote, the authors propose the corporate boardrooms should allow a further degree of shareholder democracy than is currently the case. This would offset the train of events caused by the reflective subservience cognitive dissonance interaction. While their proposition is applicable to developing countries, it may also apply to the current situation in China.

From our fieldwork it appears that, in company Boardrooms at least, the detached air of superiority of a ruling class prevailed both before and after listing. An authoritarian style of management evolving from private status no doubt created the momentum to continue with a success formula. Subservience to the leader remained paramount after listing as it did before, with a more democratic style being eschewed in favour of an autocratic rule-based system.

The existing corporate culture carries over to the brave new world of governing over a wider ownership populace. The continuing benefits of a strong and aggressively centralized management system was exemplified by the following response received from Mr Cui of KK Company, when he said

> *'The chairman of the board believes that he is strong enough to make the impossible become possible. I think the "mission statement" is a reflection of the "boss style". For example, if the chairman of the board does not pay attention to check on work attendance, he would not care whether staff are late or not. What he really cares are how the staff can finish the tasks perfectly and their work efficiency.' (Cui, KK)*

Remarkably, an attitude prevailed that equated a smaller pool of share ownership with a more effective administration, harking back to the good old days when the company was still in private hands! Wider share ownership was 'unfair' and only served to weaken 'control':

> *'Usually if the project is related to larger shareholders' interests, it is likely to be unfair. In fact, large shareholders have the strength to control the results, so the company also pays*

> *attention if the project has affiliate transaction which should be subject to regulation.' (Liu, DGT)*

Expanding the Board size was similarly perceived as dilution of control, as this response of Liu of DGT Company illustrates:

> *'The board consist of nine directors: four inside directors, two outside directors who are not involved in company management and three independent directors. As long as no affiliate transaction exists, the board of directors is efficient. However, once the affiliate transaction occurs, the board of directors is only a form.' (Liu, DGT)*

What's more, the interviewed company executives often asserted if there were any controversy over a new project, the final decision should only be made by 'the boss.' Interference by other Board members would complicate matters and would only be tolerated if the Boss agreed. As Bin of PHQ said, "whether your views can be accepted or not depended on the boss's preference."

Proposition one: If representative, these responses suggest it would be reasonable to conclude that for the typical company seeking a placement on the SZSE, the authoritarian corporate governance `vestige bias' remains in evidence immediately after listing.

INVESTOR RELATIONS

Interview responses relating to questions on investor relations were complex, but a common theme can be discerned on close reading. IR deals with the communication not only between the company and investors but also dealings with intermediaries. The latter occurs most often with security analysts once listing is achieved. It is a function sometimes seen as a subset of marketing because it effectively involves attempting to boost the value of the company's shares, akin to marketing the company's produce (Brown 1994, Rao & Sivakumar 1999, Dolphin 2004). IR professionals describe their work as providing financial media with prompt, complete and exact information about company fundamentals and future prospects (Farragher, Kleiman & Bazaz 1994).

In the West, serious research on the IR function of corporations has been conducted since the early1990s. A seminal finding by Farragher, Kleiman and Bazaz (1994) noticed a significant inverse relationship between the quality of IR and the accuracy of analyst's earnings per share forecasts. Marston and Straker (2001) similarly conducted postal questionnaires to eighty continental companies to examine the importance and development status of IR. Most of these European companies did have well established IR profession, but surprisingly they found this function was of greater importance than was often acknowledged by top management.

Dolphin (2004) explored the strategic roles of investor relations in the UK, using interviews with twenty-one communication executives. His results verified the close connection between the IR and corporate strategy functions of these companies. Another empirical study published in the same year by Hockerts & Moir (2004) noted the beneficial effect of IR on 'relationship management,' facilitating behavioural interaction both within and outside the organisation.

Bushee & Miller (2007) and Laskin (2007) extended this finding, asserting that by implementing a IR intervention program this can result in increasing a firm visibility with all significant stakeholders, including share and debt-holders, as well as their intermediaries such as analysts and credit rating agencies. To get this result they combined surveys with and personal interviews of over two hundred

small- and mid-cap companies. While our sample size was more limited, it is a similar research methodology to that used by the authors of this paper.

In China 'investor relations' is not yet such a clearly defined field of study as it is in the West. It is not regarded as a separate and delineated corporate function worthy of independent study, unlike 'marketing,' which has now achieved a venerable status. Indeed, IR is best seen as having a status of being a subset of it, and this is reflected in the interviews conducted with top management of the fieldwork sample.

A number of factors can be adduced to explain this state of affairs. Firstly, the investor relation function is not usually handled by an independent department in private companies that subsequently seek listing, so there is the prime mover effect perpetuating traditional organisation behaviours. The company secretary normally takes charge of issues that would in the West be the responsibility of IR professionals. However, this position also holds other responsibilities simultaneously and so receives scant attention.

Secondly, the rigorous procedures and standards involved in IR issues in more developed countries is still inchoate in mainland China. This was made clear in the following response to an open-ended question pertaining to the IR function in KK Company:

> *'The function of investor relations is 'more a form than content' in China now. Foreign stock markets mainly consist of institutional investors. However, domestic stock markets are almost comprised by small and individual investors whose investments are highly speculative, relying on fluctuations in stock price discrepancy. Furthermore, the average price/earning ratio is 45 for SME board on the SZSE, too high to control properly.' (Huang, KK)*

Communication between erstwhile IR personnel and security analysts is often limited to using telephones and online platforms. The face-to-face communications are somewhat casual, rather than being formal or "real,' as Mr Huang would say. If the communication adage that 'the medium is the message,' holds water, this seemingly innocuous off-handed comment by Mr Huang betrays the true state of affairs. IR is not yet seen as a worthwhile profession to cultivate in companies that see success as a function of technological prowess.

Rather, in these companies, IR is perceived to be an adjunct to corporate strategy, of value primarily in boosting sales of output. The responses to open-ended interview questions indeed reveal this is the case. Even in the few companies that begrudgingly acknowledge the crucial role that could be played by an effective IR team, management rarely sees to that it be allocated resources to enable it to play its role. According to Liu, this is currently the case at DGT, who saw IR as a 'neutral' player in the broader scheme of things:

> *'It is very hard to define the role of investor relations. Generally it is neither a curse nor a blessing, so it is neutral. Because investors do not care about the investor relations, it is useless for [company executives] to be concerned about that. Investor relations function is only a weak form. Road show is an effective channel to recommend our company, but the company rarely does that.' (Liu, DGT)*

Perhaps the reason why the IR function is seriously underestimated as a powerful development tool emanates from a perception it can have an undesirable distributional impact. One interviewed manager for example was concerned that by enhancing IR this might encourage speculation and hence

destabilize share prices. By being better informed, institutional analysts and private investors might react unpredictably, exacerbating volatility, as if the market were not to be trusted. In this 'mafia-like' mentality it rarely seemed to matter that this very process enhanced market efficiency. Bin of PHQ Company was most vehement on this matter:

> *'Individual investors do not care about the company performance. What they are pursuing is speculation, and institutional investors prefer to trade the "theme stock" as well. …' 'The investors do not ask the performance of the company, they only care whether the company will send bonus shares or not.' (Bin, PHQ)*

Another instance of this distrustful stance is provided by Liu, who saw IR as working against the company rather than for it, or at least exaggerating company 'facts' to its detriment: For this reason IR personnel do not play in formulating DGT strategy.

> *'Our company focuses on healthy, stable and rapid development, as well as avoiding over-expectations. However, the media in China is not in good health, tending to exaggerate the facts in the reports.' (Liu, DGT)*

Proposition two: For recently listed companies on the SZSE, the investor relations function is not yet perceived to play a significant role in publishing information valuing shares. This diminishes the efficacy of the transmission process by which information is impacted in that stock market.

INSTITUTIONAL ENVIRONMENT

The final group of question list pertains to the institutional environment in which the companies listed on the SZSE would now find themselves in. The gamut of potential obstacles is wide, and covers territory from the social to the political environment. Moreover, many emerging high-tech companies originating from private enterprises differ from those that developed from state-owned cooperatives in the way they had formerly interacted with their environment during their rapid growth phase. Behavioural momentum keeps this stance intact, even when they become a publicly listed company, so that it is to be expected the experiences will differ depending on the exchange. The surprise factor will be more pronounced in SZSE with its many advanced technology companies.

Che & Qian (1998) discussed these issues in China for township-village enterprises, noticing how the institutional setting will affect subsequent company policy. The social environment for private enterprises that had developed from such humble beginnings is full of uncertainties and instabilities not found in emerging state or quasi-state enterprises seeking a public placement, for the following reasons. Firstly, private enterprises were not allowed to operate until 1981, so that they had relatively shorter period in which to identify and claim their property rights. Secondly, private enterprisers suffered more severely from political crackdowns, because security of private property rights were not guaranteed to apply uniformly but only on a case-by-case basis. Finally, private enterprises often sought protection from government interference while trying to attract private investment. They then found themselves in a conflicting situation not conducive to enhancing ownership value. In short, irrespective of whatever the political fallout, these newly listed companies could be expected to be more sensitive to institutional change. In the meantime, because of financial constraints, they may be forced to rely on government protection of one department from excessive government interference by another!

Outside China, such as in the US, governments play an important role in corporate affairs (Coglianese, Keating, Michael & Healey, 2004). It is not only a single role, but also various roles, including analyst, policymaker and enforcer, depending on circumstances. According to Moon (2004), governments have recently become the prime movers in legislating for corporate social responsibility. In the UK this process has become increasingly institutionalised, Moon citing measures taken by the Thatcher and Blair governments to encourage implementation of unpredictable social agendas. The inference is that this process is being replicated in China, with perhaps an additional layer of unpredictability occasioned by a recent history of dramatic political upheavals.

Indeed, the preponderance of responses in our interviews related to the political ramifications generated by the current institutional context. The political power of a boss was seen as a counterweight to intrusion by overzealous local officials envious of the shareholders newfound prosperity, almost as if political authority wields an axe to be exercised ensuring distributional equality. Not that it was often expressed that way. According to Bin of PHQ Company, local authorities would see to it that wealth was reinvested in expanding productive capacity or 'actual industry,' rather than allowed to be dissipated in speculative activities:

> *'Local authorises' concern is that large shareholders may occupy the company's interests. Usually the boss was too cunning to protect, so that local authorises are more to make supervisions on listed companies, to protect the interests of small shareholders. The rules state that the raised funds should be invested in actual industry, rather than trading stocks which can be risky and dangerous.' (Bin, PHQ)*

Or as expressed by Huang of KK Company, at the threat of de-listing, local authorities can ensure 'irregularities' will not occur. '…As long as the listed companies do not have significant irregularities,' he said, "the regulatory authorities will not de-list them from the market."

Huang's point was that private enterprises could conceivably not have been listed without some assistance from the government officials. Others expressed this view more positively, on the grounds that successfully listed companies could expand the tax base, enabling socially beneficial projects to be started, thus effectively recouping at least some of the profits that would otherwise be spent on ostentatiously or on 'speculative activities' (or on productive ventures, but this was not usually stated.

This China equivalent of an internal 'Marshall Plan' appeared to have been entrenched in the thinking of Tai of OMH Company. The steps to a successful listing on any exchange, he said, are so fraught with administrative difficulties that it was inconceivable for an initial public offering to be successful without the support of a government instrumentality. Anything extra-ordinary or non-standard according to their rules would have made list just too 'difficult':

> *'The local governments gave us full supports at that stage. They helped us find useful resources and brokers, even placed a target for us to get listed. In fact, IPO process had complicated steps, so we could not get listed without the support from governments. Non-standard links and matters existed in the precious development of OMH, and some of them were actually difficult to figure out, even after the company's listing.' (Tai, OMH)*

For their part, and to be even-handed, some benevolent government departments do recognize some corporations may require a friendly transition period, especially after listing. Unless companies break the rules of the stock exchange or misappropriate state property, then initial misdemeanours should

not become a problem for them by an overzealous application of black letter law. In an administrative 'wink, wink' sort of way, such policies may therefore be tolerated, in the interests of 'good administration.' Moreover, such benevolent attitudes may even be embedded in the standard operating procedures of some government departments, but the very existence of this attitude is perhaps symptomatic of the difficult institutional environment faced by private companies seeking wider share ownership.

Less obvious constraints in the institutional environment include changing the rules to which corporations must adhere. These include the rules relating to auditing and borrowing. In regard to auditing, these are in general more onerous than is typically the case in Western jurisdictions. Each step usually requires co-ordination by many disparate government departments. Respondents interviewed freely admitted the process began with close inspection by the relevant authorities of the company annual reports. This was often the key factor to decide whether the company could proceed to be listed, but verification though professional and independent audits were not always forthcoming. Moreover, cross-auditing was rarely implemented, as was the case with scientific instrument manufacturer DGT:

> *'Substantial proofs are necessary including the support certificates from science & technology bureau and industrial & commercial bureau, social security certificate, environmental certificate, as well as the financial reports.' (Liu, DGT)*

In regard to the borrowing rules, the relatively undeveloped credit markets in China are another cause for concern. Preliminary evidence suggested by our fieldwork is that many companies in China, both in the private and publicly listed sectors are debt-heavy, beyond that considered normal by Western standards. This fact alone can be expected to negatively impact share values compared to jurisdictions with more efficient debt markets, but the issue more in the unpredictable nature of that market. This is so because unlike the stock markets, the market for debt is still dominated by the government sector, protecting employees but detracting from the discipline of the market. Moreover the unpredictability of the banking and credit sector adversely affects share markets because the two sectors are inextricably entwined with each other.

The disparity in the debt/equity sectors is important, but in a subtle way that makes it difficult to recognise as a source of the problem faced by SZSE investors in particular. Equity holders must rely on debt holders for information necessary to accurately determine share values. Corporations Law in the West (which presumably is replicated at least to some degree in China), normally enables creditors to intervene in company affairs if necessary by sending in receivers or liquidators in a way denied to shareholders, who must remain at arms length and only exercise their prerogative to vote at the annual general meeting of shareholders. So a symbiotic nexus exists between the company owners and company creditors, but because of this asymmetry in information the former is reliant on debt holders to enforce prudential financial management. Only be riding on the backs of creditors this ensures value remains in the shares issued by the company. As agents for shareholders, the fiduciary duty of managers to deliver the goods to the owners of the company is kept in check, but this is only possible if creditors are also disciplined. This does not seem to be the case at the moment in China.

The difficulty here is that preliminary anecdotal evidence suggests that the two primary equity markets (Shanghai and Shenzhen) are currently more efficient than the market for debt instruments (Jiang 2011a, 2011b, 2011c). The lack of transparency and fragmented capital markets in the credit and banking sector in that country effectively drags down the efficiency of all securities markets in

general, and stock markets in particular, and especially so in high beta, high-risk technological industries as found in SZSE.

If this is so, it effectively means that of the two open share markets, the most vulnerable to the negative influence of a warped capital structure will be SZSE. So by inference, equity markets there will also be less than strongly efficient, with its cause lying elsewhere (*ie* in the banking and credit sector). Further, by virtue of the Modigliani and Miller (1958, 1963) propositions and other propositions derived from their seminal contributions, this skewed information asymmetry problem prevents companies from reaching their optimal debt/equity mix, loosening the reigns that control managerial behaviour. It is as if these companies must carry excessive ballast in their capital structure that tilts their intrinsic values downwards (Edwards *et al* 1999, 2005).

By comparison with SHSE, the SZSE stock price index has indeed been relatively more volatile, implying investor behaviour is less rational there, but the explanation can be provided by behavioural imperfections caused by environmental factors.

Proposition three: Newly listed companies on the SZSE face a more uncertain environmental context which creates a less efficient stock market compared to SHSE, adversely affecting share valuations.

CONCLUSION AND SUGGESTIONS FOR FURTHER RESEARCH

The most significant result based on our interview sample of five recently listed companies on the SZSE is that formerly private companies face significant and unexpected obstacles in adapting to an open market for their shares. These obstacles stem not only from the business and financial risks appropriate to the company, but also from behavioural issues arising from the heightened degree of disclosure now expected by the new owners. Unfurling the veracity and significance of such surprises are not immediate and may entail a lagged response, perhaps extending up to a month. This response rate accords with that of recent research by Bollerslev, Engle & Woolridge (1988), Engle (2003) and Balsara *et al* (2007), but the intellectual lineage of this concept can be traced well back to the inter-war period in the so-called 'Austrian School' research program, *eg* Hicks (1939).

By listing, the new owners now have collective clout to ruthlessly impact all available information into their claims to accurately value those shares. This is after all how the efficient market hypothesis works, so it should not really come as a surprise, but this presumed managerial omniscience is not in fact reflected in practice, nor is it indicated in our interviews. Combined with other financial and behavioural effects, this informational paucity creates a divergence in capitalisations computed in the immediate post-floatation period, the divergence being from those computed via traditional discounted cash flow analysis in more stable environments. That is, 'real world imperfections' cause managers to fumble until sanity is restored, bewilderment and denial initially being the order of the day. Although it may be temporary, this uncertainty (as distinct from calculated risk) creates this state of affairs.

In sum, we postulate the apparent 'irrationality' arises in the complexity of intensified scrutiny if listing, the proximate causes of which emanate from a number of factors, including (1) the new standards of fiduciary duty now expected in corporate governance; (2) an imperative demand for maintaining a higher standard of investor relations function; and (3) to a heightened degree of sensitivity to likely political and government interventions.

Some of these issues might have been expected by management, but others not so, coming as an unwelcome side effect of having successfully listed on a stock exchange. The most recent news appears to have the most significant impact. In the worst case scenarios, we also found in our fieldwork evidence of an apparent reluctance of company boards to properly address negative finance news, only slowly releasing scarce resources to address the problem and even then doing so begrudgingly, which can be construed as a managerial manifestation of receiving unexpectedly bad news. The conclusion is consistent with many non-mainstream research traditions, including rational expectations (Sheffrin 1996), social cognition learning Bandura's (1989) and cognitive dissonance (Festinger 1957, Cooper 2007).

Whether good or bad, unexpected surprises nevertheless constitute a manifestation of 'newest' news. Accordingly, it can be postulated it is largely the degree of surprise or 'newness' factor that is responsible for an increased perception of risk. The key concept for further research may lie in further testing the extent of an empirical association between the two. Some exploratory work already conducted suggests it is indeed variations in the *time* of *receipt* of surprising news that has the greatest impact.

The effect may not be unique to the SZSE, but the evidence is pronounced there. No doubt part of the explanation for this Ostrich-like response can be attributable to the 'only what gets measured gets done' syndrome, or the professional myopia of the technological bias typical of successful companies newly listed on China's tech-heavy stock market, but it could also be attributable to the natural behavioural response in initially denying the shock of receiving unfavourable information, especially if the news is bad, which is an assertion unambiguously supported by recent ARCH/GARCH research (*eg* Canopius 2004).

APPENDIX

Management Interview Question List
Group 1：Questions relating to personal backgrounds, ambiance and context
Could you please tell me about your general education background?

Group 2: Questions relating to discipline-specific issues
Q1: How would you describe the "mission statement" of your company? Do you think it is crucial for good corporate governance? If so, why?
Q2: Does management in the company limit it self to a clearly defined core business? Do you think well defined power and responsibility are important in the company? If so, why?
Q3: Over the past five years, if there was some controversy over the acquisition and/or financing new project, how would the company management have dealt with that? Could you please give me an example?
Q4: Does the company's annual report include a section devoted to the company's performance in complementing corporate governance principles? If yes, what do you think of the necessity of that? If no, does the company plan to add this section the annual report and why?

Group 3: Questions relating to company transparency
Q1: Are information, decisions and other announcements updated promptly on the company's English language website? Do you think it is necessary and significant to have an English language website for the development of the company? If so, why?
Q2: Does the management disclose 3- or 5- year return on assets (ROA) or rate of return on common stockholders' equity (ROE) target? What do you think of the significance of this kind of information disclosure for the development of the company?
Q3: Does the company publish its Annual Report within 4 months of the end of the financial year? If not, how long after the end of the financial year does the company publish its Annual Report? What do you think of this time span?
Q4: Do you think the company consistently discloses major and market sensitive information punctually? What is your opinion about the clarity and informativeness of the reports?

Q5: Do analysts have good access to senior management in this company? (Good access hereby implies accessibility soon after results are announced and timely meetings where analysts are given all relevant information and are not misled.) If not, what are your main concerns about the information accessibility of analysts?

Group 4: Questions relating to company responsibility
Q1: If the Board/senior management have made a decision in recent years seen to benefit them at the expense of shareholders, would the company promptly correct such behaviour? If so, why? Does the company have related rules?
Q2: What kinds of mechanism does the company have to carry out punishment of the executive/management committee in the event of mismanagement?
Q3: How often are board meetings held every year? What do you think of the time span?
Q4: What is your opinion about the board size in your company? Is it effective and efficient? Is there anything that could be improved?

Group 5: Questions relating to investor relations
Q1: Does your company have a formal IR policy or written description stating the objectives and responsibilities of the investor relations function?
Q2: Over the past five years, were you involved in communications with investors? If you were involved, were the communications handled by a separate investor relations department?
Q3: Could you please define the role of investor relations within the structure of your company?
Q4: What do you think should be the essential pre-requisite for the investment relations communicator?
Q5: How long has investor relations been developed within your company?
Q6: Does the company keep a record of proceedings of meetings with analysts? Does the company keep a record of the content of telephone conversations with analysts?
Q7: Does your company prohibit or restrict communication with sell-side analysts, buy-side analysts and/or fund managers?
Q8: How many kinds of following measures has the company taken to process Investor Relations program?

	Measures taken to process investor relations program	Yes	No
1	explaining the business and its environment		
2	emphasizing future prospects rather than historical performance		
3	focusing on strategies and opportunities for long-term rather than near-term performance		
4	avoiding the creation of over-expectations		
5	facing adverse news openly and honestly		
6	being proactive rather than reactive		
7	providing analysts with access to top management		
8	including the director of investor relations in top management		
9	employing an investor relations staff that understands the common stock valuation process.		

Group 6: Questions relating to social awareness and environment
Q1: How does the company improve the implementation of equal employment policy?
Q2: Do you think that the company should adhere to specified industry guidelines on sourcing of materials? If so, how and why?
Q3: What kinds of measures does the company take to improve environmental consciousness?
Q4: How do you think of the role of related government for the relationship between listed companies and investors? Do you think the China Securities Regulatory Commission affords ample protection for the listed companies? Do you think the local government has taken the following measures to support the development of listed companies?

	Measures taken by local government	Yes	No
1	help promote the business case and celebrate business achievements		
2	support partnership and business participation in key priorities - including through co-funding, fiscal incentives and brokering new partnerships		
3	ensure Government business services provide helpful advice and signpost other resources		
4	encourage consensus on China and international codes of practice;		
5	promote effective frameworks for reporting and product labelling		

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ACKNOWLEDGEMENT
The authors wish to acknowledge financial assistance in the preparation of this paper from the China Scholarship Council, and from the School of Business, University of New South Wales Canberra. Suggestions for improvement were gratefully received from Kevin Baker, Vic Edwards, Long Jiang, Marian May and Daniel Prior. Responsibility for lacunae remains with the authors. This paper is part of a larger PhD study dealing with Individual Investor Behaviour on the Shenzhen Stock Market. Email addresses: jiaqi.sun@student.adfa.edu.au; g.manger@adfa.edu.au.