Why do firms issue bonds in the offshore market? Evidence from China

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Summary

After the 2008 financial crisis, international debt issuance rose sharply and became an important financing source for firms from emerging economies. A large body of literature argues that, rather than providing abundant liquidity, offshore financing could benefit emerging-market firms by improving their creditability and corporate governance. This view is often referred to as the “bonding” hypothesis, arguing that raising funding or cross-listing outside home countries suggests a commitment to a relative stringent jurisdiction with more information disclosure and better investor protection. Therefore, offshore bond issuance would make the issuer more transparent and creditable, which, in turn, sends positive signals to domestic markets and therefore improves the debtor’s financing conditions.

Although the bonding hypothesis has been the topic of much discussion, the bonding/signalling effect remains controversial. In this study, we investigate whether the bonding/signalling effect remains valid for emerging-market firms after they have raised funds in the international market with a more stringent regimen.

To shed light on this issue, we construct a comprehensive dataset, including the bond issuance internationally and domestically by Chinese firms from 2010-2015. Based on the Chinese data, a country with strict capital control and large institutional disparity between onshore and offshore, our study provides a micro-level investigation of the bonding/signalling effect on China's domestic market, which is associated with poor transparency and credit risks.

We arrive at four main conclusions: 1) The offshore bond issuance improves the funding terms of the issuer in the subsequent domestic bond issuance in terms of longer maturity of corporate issuance and lower funding cost; 2) The change of financing terms is more significant for domestic issuance by firms that have been issued bonds offshore under public issuance or an international investment-grade rating. 3) Offshore financing favours financially constrained firms than their less-constrained peers in their subsequent domestic issuance. 4) Offshore bonds issued with a registration domain in Hong Kong, under Hong Kong law or listed on the Hong Kong exchange market have a stronger signalling effect on the subsequent domestic issuance than other offshore locations.

Compared to existing literature, our study strongly supports the bonding hypothesis in the bond markets and is the first to use debt issues data, rather than cross-listing of equity shares. Also, our study underscores the importance of developing an offshore bond market for emerging economies and offers important policy suggestions for emerging markets with similar institutional restrictions.