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Bait and Switch: How Do Chinese Firms Use Proceeds from Seasoned Equity Offerings

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Abstract

We reveal motivations of Chinese firms for issuing Seasoned Equity Offerings (SEO) by examining why firms change the use of SEO proceeds and how they use unspecified SEO proceeds. Using 533 SEOs issued by Chinese firms during 1999-2006, we find that firms do not use unspecified SEO proceeds on capital investment regardless of the nature of controlling shareholders. We find that if the controlling shareholder is the state, then the firm uses unspecified proceeds to stockpile cash; if the controlling shareholder is a parent state-owned enterprise, then the firm uses unspecified proceeds on retiring debt and on related party transactions.

JEL-Code: G300, G320, L200.

Keywords: Seasoned Equity Offerings (SEO), use of SEO proceeds, SEO motives, controlling shareholders.

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1. Introduction

Firms are supposed to have good reasons to issue Seasoned Equity Offerings (SEO). According to the pecking order theory of corporate finance (Myers and Majluf, 1984), a firm will only use equity financing when it has to do so, because asymmetric information is the severest for equity financing among means of external financing. However, contrary to theory, firms are passionate about using SEOs to raise additional equity (e.g. Henderson, et al., 2006; Fama and French, 2005). This obvious discrepancy between theory and practice calls for academic attention on why firms frequently use SEOs to raise additional capital.

The fundamental principle of corporate finance requires that a firm's equity financing behaviour is in line with shareholders' interest. However, a historical puzzle concerning SEOs is that issuing firms often suffer from underperformance in the years subsequent to SEOs in terms of both long-term stock returns (e.g. Loughran and Ritter, 1995; Spiess and Affleck-Graves, 1995) and long-term operating performance (e.g. Loughran and Ritter, 1997). Although the phenomenon of SEO underperformance is widely documented, the mechanisms through which SEOs bring about underperformance have been mainly confined to the market timing explanation, while other possible mechanisms are still not explicitly investigated in the literature. Recently, research on corporate SEO behaviour has been focusing on why firms want to issue SEOs (Dittmar and Thakor, 2007) and who are issuing equity (Fama and French, 2005). There are four conventional theories regarding SEO motives: financing for investment, adjusting capital structure, avoiding agency problems, and market timing (see Bo et al., 2011). In addition, DeAngelo et al. (2010) document that the near-term need for cash also drives firms to issue SEOs.

It is important to note that recent research on SEO motives is a response to the puzzle of SEO underperformance. Scholars want to link the firm's true motivations for issuing SEOs with the consequences of these SEOs on the firm's long-term performance. A general approach taken by the research on SEO motives is to examine how the firm uses SEO proceeds (Jeanneret, 2005; Kim and Weisbach, 2008; Walker and Yost, 2008; Autore et al., 2009; and Fu, 2010). The logic of this line of research is either to explain changes in the firm's accounting variables subsequent to SEOs by the use of

SEO proceeds or to examine whether the firm's post-issue performance differs across types of the use of SEO proceeds. An alternative approach is to examine SEO motives by linking the firm's pre-issue real and financial activities to the issuance of SEOs in order to reveal what drives the firm to issue SEOs (e.g. Bo et al., 2011; DeAngelo et al., 2010). Hence the connection between the firm's pre-issue characteristics and SEOs can provide indirect inference concerning why the firm issues SEOs.

The use of SEO proceeds should be consistent with one or more of the above-mentioned SEO motives. If the firm issues SEOs for the purpose of financing new investment, we should observe that the firm would use SEO proceeds on capital expenditures; if the firm issues SEOs in order to re-adjust its capital structure, we should observe that the firm would use SEO proceeds to retire debt; if the firm issues SEOs to relieve near-term liquidity pressure, then we should observe that the firm uses SEO proceeds on short-term operating expenditures, such as cash stock. However, the ambiguity arises if the firm issues SEOs as a result of agency conflicts or the firm issues SEOs to take the advantage of the overvalued stock prices, i.e. to time the market, under which circumstances it is difficult to predict what will be the ultimate use of SEO proceeds. Since in both cases, SEO proceeds can be used with a great deal of managerial discretion. Therefore, it is important to examine where these SEO proceeds are ultimately used in order to reveal true motivations of the firm for issuing SEOs. However, the research on SEO motives has been mainly based on mature stock markets, and certainly not in detail for a highly interesting market, our example case of China.

Chinese firms have been active in using SEOs to raise equity capital (e.g. Bo et al., 2011). One important observation from the Chinese stock market is that firms often specify the intended/planned use of proceeds from issuing SEOs in their proxy reports beforehand, but after conducting SEOs firms often change the use of SEO proceeds. For example, based on the 533 sample SEO cases over 1999-2006 that we examine in this paper, the average ratio of planned use of SEO proceeds on investment to total SEO proceeds is 95.29%, but the average ratio of realised use on investment to total SEO proceeds is 73.60%. This suggests that a significant proportion of SEO proceeds (22.34%), being specified in firms' proxy reports to finance new investments, has been switched to elsewhere. In addition, based on this sample, we

also observe that the average ratio of planned use of SEO proceeds for corporate general purposes is 3.69%, but the average ratio of realised use for corporate general purposes is 25.97%. Obviously, firms have switched the use of SEO proceeds (22.27%) from elsewhere to the category of corporate general purposes. Taking together, we observe that firms promise potential investors to use SEO proceeds on new investment in their issue reports, but after SEOs are issued, many firms change the plan of using SEO proceeds by putting more SEO proceeds into the category of corporate general purposes, while in the meantime they reduce the use of SEO proceeds on new investment. We refer the above-mentioned conduct to the "bait and switch" tactic regarding the use of SEO proceeds. It is important to note that the destination for the use of SEO proceeds in the category of general corporate purposes is unspecified, the firm is not legally required to declare how and where these SEO proceeds will be used ultimately, hence the use of these unspecified SEO proceeds can reveal true motivations of the firm for issuing SEOs. Moreover, we also observe that such "bait and switch" behavior is observed for the majority of issuing firms in our sample. More specifically, out of total 533 sample SEO cases we examine in this paper, there are 377 cases (70.73%) that have increased the amount of SEO proceeds in the category of corporate general purposes. The above-mentioned observations make people sceptical about true motivations of the firm for issuing SEOs. How to explain this "bait and switch" behaviour regarding the use of SEO proceeds? Whether or not controlling shareholders of such firms are involved in this "bait and switch" tactic? How do firms use unspecified SEO proceeds ultimately? In this paper, we provide answers to these questions.

We examine 533 SEOs issued by Chinese firms during 1999-2006.[1] We pay special attention to the use of SEO proceeds in the category of corporate general purposes. Because the destination for the use of this type of SEO proceeds is officially unspecified and essentially unknown, the ultimate use of these unspecified SEO proceeds can reveal true motivations of the firm for issuing SEOs. Given that the observed problem is the "bait and switch" tactic regarding the use of SEO proceeds, the most suspicious

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[1] In order to examine how the firm uses unspecified SEO proceeds, we need to follow every SEO case to 3 years after the SEO year, therefore, our effective sample period covers the period of 1999-2009.

reason why firms conduct such a "bait and switch" tactic concerns controlling shareholders of issuing firms. This conjecture is supported by the widely documented evidence that the conflict between controlling shareholders and minority shareholders is severe in Chinese listed firms (e.g. Jiang et al., 2010; Berkman et al., 2009). Therefore, we focus on how the nature of controlling shareholders is associated with such "bait and switch" behavior regarding the use of SEO proceeds. The results show that the controlling shareholder's ownership significantly increases the probability of changing the use of SEO proceeds, particularly when the controlling shareholder is the state or a parent State-Owned Enterprise (SOE) of the listed firm. For firms in which controlling shareholders are other legal persons (mainly private), there is no clear-cut connection between the controlling shareholder's ownership and the likelihood of switching. In the second step of the empirical analysis, we examine how firms use unspecified SEO proceeds. We document that sample firms in general do not use unspecified SEO proceeds on capital investment regardless of the nature of controlling shareholders. However, the nature of controlling shareholders does matter for the use of SEO proceeds on other activities rather than capital investment. The results show that (a) the state-controlled firms often use unspecified SEO proceeds to stockpile cash up to 3 years after SEOs, (b) the firms that are controlled by their parent SOEs use unspecified SEO proceeds to retire debt and to conduct related party transactions, suggesting that the "bait and switch" tactic may be used by the controlling shareholder for the purpose of tunneling, and (c) there is no clear-cut result concerning how firms in which controlling shareholders are other legal persons use unspecified SEO proceeds.

We contribute to the literature from the following two aspects. Firstly, we reveal SEO motives by examining *ex post* information on the use of *unspecified* SEO proceeds, i.e., we examine how the firm ultimately uses SEO proceeds in the category of corporate general purposes that are unspecified in use beforehand, whereas previous studies have mainly used either total SEO proceeds (e.g. Kim and Weisbach, 2008) or *ex ante* (the stated) information on the use of SEO proceeds in the category of corporate general purposes (e.g. Jeanneret, 2005; Autore et al., 2009). It is worth mentioning that using *ex ante* (the stated) information on the use of unspecified SEO proceeds to infer SEO motives can only be a

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valid approach if the firm does not change the plan regarding the use of SEO proceeds after the issuance, which is rarely seen in the corporate practice. Moreover, since total SEO proceeds contain all types of use, including investment, debt repayment, and corporate general purposes, it is difficult to infer SEO motives if total SEO proceeds are used. Therefore, in this paper we pay special attention to the realized use of SEO proceeds in the category of corporate general purposes. Because the destination for the use of this type of SEO proceeds is essentially unknown, the ultimate use of these unspecified SEO proceeds can reveal true motivations of the firm for issuing SEOs. It may be the nature of ambiguity of this category that provides the firm with a lot of flexibility in deciding how to use SEO proceeds ultimately.

Secondly, we contribute to the SEO literature by providing some new evidence on how features of Chinese corporate governance distinguish Chinese firms from mature firms regarding the use of SEO proceeds. More specifically, we provide two results revealing Chinese characteristics. First, we show that the state-dominated formal financing channel and the large state ownership of listed firms in China result in distorted allocation of capital raised from the stock market. Although it is widely documented that Chinese small and private enterprises have been lack of access to formal financing, many state-controlled firms, taking the advantage of being state-connected, can easily time the market in issuing seasoned equities and then stockpile SEO proceeds as cash for other purposes. Second, we provide new evidence on whether or not Chinese controlling shareholders are expropriating wealth from minority shareholders by examining the use of SEO proceeds. The standard SEO literature developed based on firms in mature market economies documents that the most common governance problem involved in the use of SEO proceeds is agency conflict between managers and shareholders (Autore et al., 2009; Walker and Yost, 2008; and Fu, 2010). There is no available study on whether or not the conflict between controlling shareholders and minority shareholders explains the use of SEO proceeds. It is important to note that firms in emerging market economies suffer more serious conflict between controlling shareholders and minority shareholders as compared to firms in mature markets (e.g. La Porta et al., 1999; Claessens et al., 2000; and Johnson et al., 2000). Moreover, it is widely documented that the conflict between controlling shareholders and minority shareholders is severer in Chinese listed firms (e.g. Jiang et al. 2010; Berkman

et al. 2009). However, little attention is paid to this problem in the context of the use of SEO proceeds. To the best of our knowledge, the existing literature on Chinese corporate governance have never examined such "bait and switch" behaviour regarding the use of SEO proceeds in order to reveal the most prevailing conflict between controlling shareholders and minority shareholders suffered by Chinese listed firms.

The rest of the paper is organized as follows. Section 2 reviews the relevant SEO literature. Section 3 presents the data. Section 4 concerns empirical models and measurement of variables. Section 5 discusses empirical results. Section 6 concludes.

2. The related SEO literature

In the literature many studies on the use of SEO proceeds are designed to reveal SEO motives, which in turn helps explain why firms often suffer from underperformance subsequent to SEOs. We divide these studies into two streams: (a) studies on the relationship between changes in accounting variables and the use of SEO proceeds; and (b) studies that link the use of SEO proceeds to firm performance.

The logic of linking the use of SEO proceeds to accounting variables is to examine whether the use of SEO proceeds contributes to changes in some accounting variables subsequent to SEOs. Using 12373 SEOs from 38 countries during 1990-2003, Kim and Weisbach (2008) examine how the use of SEO proceeds explains changes in some accounting variables, including capital expenditures, R&D, cash holding, and long-term debt reduction, inventory, etc. The authors provide evidence in supportive of both the financing for investment motive and the market timing motive, but there is no evidence that the firm uses SEO proceeds to repay long-term debt.

The main objective of studies linking the use of SEO proceeds to firm performance is to examine whether the use of SEO proceeds is a contributing factor to underperformance subsequent to SEOs. Using a sample of French rights offers, Jeanneret (2005) documents that sample firms' long-term post-issue performance differs among types of use of SEO proceeds. More specifically, Jeanneret (2005) classifies the SEO samples based on *ex ante* (the stated/intended) information on the use of SEO proceeds into two

subsample groups, i.e., SEOs that are designated to finance new investment and that are designed to re-adjust capital structure (debt repayment). Jeanneret (2005) finds that for the subsample of SEOs that are claimed to finance new investment, the issue firms suffer from long-run underperformance in stock returns, whereas SEO firms aiming to adjust capital structure do not suffer from underperformance. Jeanneret (2005) attributes the result concerning financing for investment to the overvaluation of investment payoffs and the persistence of this over-optimism through time.

More recently, Autore et al. (2009) classify the use of SEO proceeds into three types, i.e., investment, debt repayment, and corporate general purposes. They examine *ex ant*e (the stated) use of SEO proceeds and the firm's post-SEOs long-term performance. These authors document negative abnormal returns for SEOs that are stated to repay debt and for corporate general purposes, whereas for SEOs that are stated to be used to finance new investment, there is no subsequent underperformance. Therefore, Autore et al. (2009) conclude that firms use SEOs to signal outside investors about the firm's growth opportunities by explicitly stating that they will use SEO proceeds on new investment, whereas for SEOs that are stated to repay debt and for corporate general purposes, the firm issues SEOs mainly to time the market. Both Jeanneret (2005) and Autore et al. (2009) analyze *ex ante* (the stated/intended) information on the use of SEO proceeds reported in the firms' proxy statements. It is worth mentioning that using *ex ante* (the stated/intended) information on the use of proceeds to reveal SEO motives can only be a valid approach if the firm does not change the plan regarding the use of SEO proceeds, which may be arguably the case in mature stock markets with strong investor protection but it is hardly the case for emerging markets due to weak investors' protection.

The signalling role of the SEO announcement is examined by Walker and Yost (2008), who link the use of SEO proceeds with the firm's stock market reactions to the announcement of the firm's SEOs. They claim that when the firm is given a choice between specifying the use of SEO proceeds and being ambiguous about it, only will the firms with good investment projects (i.e. growth opportunity) choose to specify the use of SEO proceeds. Alternatively, if the firm does not have good investment projects or the firm does not specify the use of SEO proceeds due to strategic concerns, then the firm will choose to be

ambiguous about the use of SEO proceeds in their issuing reports. Therefore, the firm that specifies the use of SEO proceeds will use the SEO announcement to signal the market about the firm's confidence in future growth, which mitigates the asymmetric information problem. On the contrary, the cost of equity financing will be higher for the firms that choose to be ambiguous about the use of SEO proceeds. Following this logic of reasoning, Walker and Yost (2008) first classify their sample firms into three subgroups based on the stated (*ex ante*) primary use of the proceeds: investment, debt repayment, and corporate general purposes. They then explain the abnormal announcement returns by the standard event study methods against SEO proceeds controlling for other relevant variables for these three subgroups of firms, respectively. They find that the stock market reacts positively for firms that specify the use of proceeds for investment, but negatively for firms that choose to be ambiguous about the use of SEO proceeds by putting them into the category of corporate general purposes. The latter result can be explained by the dominance of the firms who choose not to specify due to agency problems of managerial rent-seeking, whereas the former result can be explained by that the information asymmetry problem is less severe for firms with good investment opportunities. Walker and Yost (2008) also document that, although the firm's stated use of SEO proceeds is to repay debt, the firm actually does not use additional equity to repay debt.

Fu (2010) analyzes the firm's post-SEO operating performance by one particular type of use of SEO proceeds, i.e., overinvestment resulted from the agency conflict between managers and shareholders. He first checks four major types of uses of SEO proceeds: investing, retiring debt, increasing working capital, and hoarding cash. Fu (2010) documents that the dominant use of SEO proceeds is to expand investment mainly including capital expenditures and acquisition expenses. Firms do not primarily use SEO proceeds to retire debt. The increase in working capital is not significant in the long-run. Firms tend to hoard some SEO proceeds in cash. Since SEO proceeds are used dominantly on investment, Fu (2010) constructs a proxy for overinvestment measured by the difference between the issuing firm's investment and the investment of the matched non-issuing firms. He finds a negative relationship between overinvestment and the firm's post-SEO operating performance. Fu (2010) attributes the negative impact of

overinvestment on the firm's post-SEO operating performance to the free cash flow problem that results from agency conflicts between managers and shareholders.

Based on the above-reviewed literatures on the use of SEO proceeds, we can summarise that (1) There are mainly three types of uses of SEO proceeds mentioned in the literature, i.e., investment, debt repayment, corporate general purposes (e.g. Autore et al., 2009; Walker and Yost, 2008; and Jeanneret, 2005). Since the use of SEO proceeds for corporate general purposes contains all unspecified destinations for the use of SEO proceeds, it is very likely that this type of use conceals true motivations of the firm for issuing SEOs. For this reason some studies treat whether or not the firm chooses to explicitly specify the use of SEO proceeds as a signal to the stock market (e.g. Walker and Yost, 2008; and Autore et al., 2009); (2) Among the above-mentioned SEO motives, SEO proceeds have been often used on new investment in many studies (e.g., Kim and Weisbach, 2008; Autore, et al., 2009; Walker and Yost, 2008; and Fu, 2010), but there is in general no evidence supporting the debt repayment motive (e.g., Kim and Weisbach, 2008; Walker and Yost, 2008; DeAngelo, et al., 2009; and Fu, 2010). The near-term need for cash as a SEO motive has received weak support (Fu, 2010). These studies find that SEO proceeds are mainly used either as a result of governance problems or due to market timing concerns, or both (e.g., Kim and Weisbach, 2008; Autore et al., 2009; Walker and Yost, 2008; and Fu, 2010); (3) The literature documents that the most common governance problem involved in the use of SEO proceeds is the agency conflict between managers and shareholders; little attention has been paid to the conflict between controlling shareholders and minority shareholders; (4) The main stream research on the use of SEO proceeds mainly focus on mature stock markets such as the US and the French stock markets. To the best of our knowledge, there is no study available in the published outlets that examines the connection between the nature of controlling shareholders and the use of SEO proceeds in the Chinese stock market. We fill in the gap in this respect.

3. The Data

Our data are taken from the CCER/Sinofin database, which tracks the firm's announcements of the use of SEO proceeds. Our research covers the period from 1999 up to and including 2006. The reason why we start from 1999 is because information on both the ownership structure and the cash flow statement for Chinese listed firms only became available in 1998 and we need the one-year lagged observations for many variables. We start with all SEO cases in the Chinese stock market during 1999-2006. Among these SEO cases we further track down the SEO cases that report the information on the ultimate use of proceeds. Since we need to follow the firm's real and financial activities up to three years after the issuance of SEOs, we use SEO cases up to and including 2006 to ensure that the observations on the variables are available in three years subsequent to SEOs. Therefore, our effective sample period is 1998-2009, but we use the SEO cases during 1999-2006 in the econometric models. There are 533 SEO cases during 1999-2006 whose information on the ultimate use of SEO proceeds is available, which accounts for 74.02% of total SEOs in the same period. Therefore, our sample is reasonably representative of SEO activities in the Chinese stock market during 1999-2006.

For each SEO case we identify types of use of proceeds. Following the standard literature, we classify the use of SEO proceeds into three types: real investment (USE^{Invest}), debt repayment (USE^{Debt}), and corporate general purposes ($USE^{General}$). The use of proceeds employed in the empirical analysis of this paper is the ultimate/realised use. We pay special attention to the use of SEO proceeds in the category of corporate general purposes ($USE^{General}$). Obviously, it is highly likely that the firm can easily hide its true motivations for issuing SEOs by putting SEO proceeds into the category of corporate general purposes. The destination for the use of this type of SEO proceeds is essentially unknown because it is unspecified. Therefore, we focus on the use of unspecified SEO proceeds ($USE^{General}$) in order to reveal true motives for SEOs.

Table 1 Types of use of SEO proceeds

	Planned USE^{Invest} (%)	Realized USE^{Invest} (%)	Change USE^{Invest} (%)	Planned USE^{Debt} (%)	Realized USE^{Debt} (%)	Change USE^{Debt} (%)	Planned $USE^{General}$ (%)	Realized $USE^{General}$ (%)	Change $USE^{General}$ (%)	Obs.
	(1)	(2)	(3)= (2)-(1)	(4)	(5)	(6)=(5)-(4)	(7)	(8)	(9)=(8)-(7)	
1999	92.49	65.21	-27.28	0.47	0.44	-0.02	7.01	34.33	27.32	106
2000	92.38	67.71	-25.25	0.82	0.92	0.10	6.80	31.96	25.15	175
2001	95.28	75.42	-19.86	0	0	0	4.71	24.57	19.86	87
2002	97.22	69.41	-27.80	0.66	0	-0.66	2.11	30.58	28.47	46
2003	95.61	88.14	-7.46	0.69	2.01	1.31	3.69	9.84	6.15	39
2004	97.66	77.56	-20.09	0	0	0	2.33	22.43	20.09	32
2005	100	77.05	-22.95	0	0	0	0	22.95	22.95	3
2006	96.43	68.33	-28.09	0.62	0.49	-0.12	2.94	31.16	28.22	45
Average/ total	95.29	73.60	-22.34	0.40	0.48	0.07	3.69	25.97	22.27	533

Notes:

(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*

(2) USE^{Invest} stands for SEO proceeds that are used on investment; USE^{Debt} stands for SEO proceeds that are used on debt repayment; $USE^{General}$ stands for SEO proceeds in the category of corporate general purposes.

Table 1 provides a summary of three types of use of SEO proceeds. There are two patterns emerging from Table 1. Firstly, it shows that the sample firms mainly use SEO proceeds on either investment or corporate general purposes. They use very little SEO proceeds (or zero) on debt repayment. The difference between the planned use and the realized use for debt repayment is ignorable. Secondly, we observe from Table 1 that in each year during the sample period, the ratio of realized SEO proceeds used for new investment to total SEO proceeds is always lower than the ratio of planned use for investment, which suggests that firms often cut the amount of SEO proceeds used for investment after the issuance. On the other hand, the ratio of realized SEO proceeds used for corporate general purposes to total SEO proceeds is always higher than the ratio of planned use for corporate general purposes, suggesting that firms often increase the amount of SEO proceeds used for corporate general purposes after the issuance. These statistics provides us with preliminary evidence that the sample firms switched the use of SEO proceeds from the investment category to the category of corporate general purposes. It is important to note that the destination for the use of SEO proceeds in the category of corporate general purposes is officially unspecified and essentially unknown.

4. Empirical models and measurement of variables

4.1 The empirical model for the change in the use of SEO proceeds

The objectives of our empirical analysis are to explain why firms increase the use of SEO proceeds for corporate general purposes and how they use these unspecified SEO proceeds. We denote total SEO proceeds in the category of corporate general purposes as $USE^{General}$ and the change in SEO proceeds in this category as $\Delta USE^{General}$. As shown in Table 1, when sample firms change the use of proceeds in the category of corporate general purposes, they always increase the amount of SEO proceeds in this category, hence $\Delta USE^{General}$ is always positive. Therefore, in this paper by the change in use of SEO proceeds we mean the increase in the use of SEO proceeds for corporate general purposes.

In the first step of the empirical analysis we estimate a Probit model in which the dependent variable is a dummy variable indicating whether or not the firm changes (increases) the use of proceeds

for corporate general purposes. We define *Change* =1 if the firm has put more SEO proceeds into the category of corporate general purposes after issuing SEOs, and *Change* =0 otherwise. We measure the change in the use of proceeds for corporate general purposes ($\Delta USE^{General}$) in two ways: (a) Change in the absolute amount of SEO proceeds for corporate general purposes, i.e. $\Delta USE^{General}$ = Realized $USE^{General}$ - Planned $USE^{General}$; (b) Change in the ratio of the use of SEO proceeds for corporate general purposes to total SEO proceeds, i.e. $\Delta USE^{General} Ratio$ =Realized $\left(USE^{General}/Total\,procceds\right)$ - $Planned\left(USE^{General}/Total\,procceds\right)$, which is the difference between the realized ratio of use of SEO proceeds for corporate general purposes to total SEO proceeds and the planned ratio of use in this category to total SEO proceeds. We use two measures of changes in the use of SEO proceeds for corporate general purposes mainly for the sake of checking robustness. $\Delta USE^{General}$ captures changes in SEO proceeds in the same category (corporate general purposes) after and before the SEO issuance, whereas $\Delta USE^{General} Ratio$ captures changes of SEO proceeds for corporate general purposes in relation to total SEO proceeds after and before the SEO issuance, the latter measure also contains information on other types of use of SEO proceeds.

The following Probit model is estimated to explain the change in the use of SEO proceeds for corporate general purposes:

$$\Pr obit(Change) = \beta_0 + \beta_1 Size_i + \beta_2 Sales_i + \beta_3 Leverage_i + \beta_4 \Pr eStock\operatorname{Re}turn_i + \beta_5 Top1_i + \varepsilon_i \qquad (1)$$

Where *Change* =1 if either $\Delta USE^{General} > 0$ or $\Delta USE^{General} Ratio > 0$, respectively. The purpose of estimating the empirical model (1) is to examine factors explaining the likelihood of changes in the use of SEO proceeds for corporate general purposes, especially we are interested in whether or not the firm's controlling shareholder is involved in the "bait and switch" tactic regarding the use of SEO proceeds. *Top*1 represents the voting and control power of the controlling shareholder of the firm, which is measured by the ratio of shares held by the largest shareholder to total shares of the firm. We include some other relevant factors: (1) firm size (*Size*), which is measured by the natural log of the firm's total assets. Firm

size is important for the sources of financing accessible to the firm and hence it is relevant to how the firm uses SEO proceeds. (2) Sales ($Sales$) refers to the firm's sales growth, which is measured by the annual growth rate of sales. It is possible that the firm changes its use of SEO proceeds due to the change in its growth opportunity after SEOs. (3) Leverage ($Leverage$) is measured by the ratio of total debt to total assets of the firm. Leverage is relevant for the firm when deciding how to use SEO proceeds. The availability of other sources of financing, such as borrowing and financial burdens associated with such borrowing, are relevant to the firm's decision on the use of SEO proceeds. (4) The literature shows that Chinese firms intent to issue SEOs motivated by timing the market (e.g. Bo et al., 2011). Therefore, it is logical to include the firm's pre-issue stock market returns ($\Pr eStock \operatorname{Re} turn$) since the firm would adjust its use of SEO proceeds in response to changing market conditions. In the estimation, we use the observations taken from one year before the SEO year for $Size$, $Sales$, $Leverage$ and $Top1$. $\Pr eStock \operatorname{Re} turn$ is measured by the 12 months stock returns of the firm's shares before SEOs.

4.2 The empirical model for the use of unspecified SEO proceeds

In order to examine how the firm uses unspecified SEO proceeds, i.e., SEO proceeds in the category of corporate general purposes, we follow the modeling strategy proposed by Kim and Weisbach (2008) (hereafter the KW model). The KW model aims to explain whether or not SEO proceeds contribute to the changes in some accounting variables reflecting the firm's real and financial activities, including the changes in total assets, inventory, capital expenditures, acquisitions, R&D, cash holdings, and reduction of long-term debt. Hence the dependent variable in the KW model is the change in a specific variable and the independent variables include SEO proceeds, firm size, year-dummies, and other sources of funds excluding SEO proceeds. Variables in the KW model are used in the form of the log transformation to minimize the effect of potential outliers. The original KW model can be written as:

$$Y = \beta_0 + \beta_1 \ln(TA_{t-1}) + \beta_2 \ln(\frac{\sum_{i=0}^{t} Othersources}{TA_{t-1}} + 1) + \beta_3 \ln(\frac{\Pr oceeds}{TA_{t-1}} + 1) + \beta_4 \, yeardummy + \varepsilon$$

$$(2)$$

where $t=0$ refers to the year when the firm issues SEOs and $t=0,1,2,3$; Y stands for the dependent variable of concern.[2] For the balance sheet variables, the dependent variable in the KW model is constructed as the log of one plus the change in each variable normalized by total assets prior to the SEO issuance, whereas for variables taken from the income statement and the cash flow statement, the dependent variable is constructed as the log of one plus the accumulation of each variable since the SEO issuance, normalized by total assets prior to the SEO issuance. TA stands for total assets of the firm. In the original KW model $\Pr oceeds$ stands for total SEO proceeds; $Othersources$ stands for other sources of funds excluding SEO proceeds, which is measured as the sum of net cash flow from operations, cash inflow from disinvestment, and cash inflow from financing activities excluding proceeds from the current SEOs. In sum, the logic of the KW model (2) is to explain whether or not SEO proceeds contribute to the changes in the accounting variable of concern after controlling for other possible sources that could also contribute to the change in the variable of concern.

We modify the KW model for our purposes of study. Firstly, we focus on the use of SEO proceeds in the category of general corporate purposes because it can more accurately reveal true motivations of firms for issuing SEOs. We use both $USE^{General}$ and $\Delta USE^{General}$ as key independent variables (in the form of log transformation), respectively. Secondly, we add the firm's sales into the estimation since it is the most fundamental variable determining the firm's overall performance, which is relevant to the changes in other accounting variables. We also control for year dummies. Industry effects are controlled by using the industry clusters-robustness estimates. More specifically, we estimate the following model:

$$Y_i = \beta_0 + \beta_1 Size_i^{kw} + \beta_2 Sales_i^{kw} + \beta_3 Othersources_i^{kw} + \beta_4 USE_i^{General-kw} + \varepsilon_i \qquad (3)$$

In this model, we use superscript kw to indicate that the variables of concern are constructed in line with the original KW model, i.e. in the form of log transformation. We use four dependent variables in estimating the model (3), respectively. Firstly, we examine whether SEO proceeds in the category of corporate general purposes are used to support capital expenditures. More specifically, the dependent

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[2] For simplicity, we omit the firm's subscript in model (2).

variable in this estimation is the log of one plus the accumulation of capital expenditures from the SEO

year up to three years subsequent to SEOs, normalized by prior issue total assets, i.e.,

$CapExp^{kw} = \ln(\dfrac{\sum\limits_{i=0}^{t} CapExp}{TA_{t-1}} + 1)$. In this estimation, our key independent variable is either (a) the log of one

plus total SEO proceeds in the category of corporate general purposes scaled by prior issue total assets, i.e.

$USE^{General-kw} = \ln(\dfrac{USE^{General}}{TA_{t-1}} + 1)$ or (b) the log of one plus change in SEO proceeds in the category of

general corporate purposes scaled by prior issue total assets, i.e. $\Delta USE^{General-kw} = \ln(\dfrac{\Delta USE^{General}}{TA_{t-1}} + 1)$.

$Othersources^{kw}$ stands for other sources of funds excluding SEO proceeds, which is defined as the same as

that in the original KW model, i.e. $Othersources^{kw} = \ln(\dfrac{\sum\limits_{i=0}^{t} Othersources}{TA_{t-1}} + 1)$. We also control for the sales

condition faced by the firm and use $Sales^{kw} = \ln(\dfrac{(Sales_t - Sales_{t-1})}{TA_{t-1}} + 1)$. Firm size ($Size^{kw}$) is the log of

prior issue total assets of the firm as it is in the original K&W model, i.e., $Size^{kw} = \ln(TA_{t-1})$. After

controlling for other possible contributing factors, we are able to examine whether or not the unspecified

SEO proceeds in the category of corporate general purposes can explain the accumulation of capital

expenditures up to 3 years after SEOs,

Secondly, we examine whether unspecified SEO proceeds in the category of general corporate

purposes can explain changes in the firm's borrowing after SEOs. The dependent variable in this

estimation is the log of one plus the change in the firm's total debt normalized by prior issue total assets,

i.e., $Debt^{kw} = \ln(\dfrac{Debt_t - Debt_{t-1}}{TA_{t-1}} + 1)$. We use the same group of independent variables in this model.

Thirdly, in the literature the firm's market to book ratio is often chosen as a proxy for testing the

market timing motive of SEOs (e.g. Baker and Wurgler, 2002). However, a higher market to book ratio

may also indicate that the firm has a greater growth potential, and the firm that issues SEOs when its

stock is overvalued may want to raise capital to finance new investment but not necessarily to time the market. Firms that use SEO proceeds to finance investment when its market to book ratio is high should then be separated from those that issue SEOs to take the advantage of overvaluation. Kim and Weisbach (2008) document that the firms that really time the market will stockpile cash after SEOs. Hence we use the changes in the firm's cash stock to infer the market timing motive for SEOs. In addition, using changes in the cash stock as the dependent variable in estimating the model (3) can also reveal whether or not the firm issue SEOs for the near-term need for cash (e.g. DeAngelo et al., 2010). In this model specification, the dependent variable is the log of one plus the change in the firm's cash stock ($Cash$) scaled by the firm's prior issue total assets, i.e. $Cash^{kw} = \ln(\dfrac{Cash_t - Cash_{t-1}}{TA_{t-1}} + 1)$.

As we discussed earlier, the firm's decision to change the use of SEO proceeds is likely due to the manipulation of controlling shareholders. In the Chinese context, Related Party Transaction (RPT) is widely documented to be a popular way used by controlling shareholders to tunnel assets away from their listed firms at the expenses of minority shareholders (e.g. Jiang et al., 2010; Berkman et. al., 2010). In addition, Jian and Wong (2004) document that Chinese firms often increase related party transactions after SEOs, suggesting that SEOs provide resources for such tunneling behavior. Hence we examine whether or not the unspecified SEO proceeds in the category of corporate general purposes can explain the changes in related party transaction (RPT) after SEOs. In this model specification, the dependent variable is the log of one plus the change in the volume of related party transaction normalized by prior issue total assets, i.e., $RPT^{kw} = \ln(\dfrac{RPT_t - RPT_{t-1}}{TA_{t-1}} + 1)$. Table 2 provides summary statistics of the variables used in the empirical analysis.

Table 2 Summary Statistics

	Whole		Top1state		Top1soe		Top1others	
	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Size	21.3433	0.9204	21.3718	1.0232	21.3582	0.9264	21.2956	0.8236
Sales	0.2916	0.3826	0.2304	0.3217	0.2859	0.3720	0.3500	0.4356
Leverage	0.2213	0.1334	0.2293	0.1417	0.2121	0.1303	0.2305	0.1315
Pr*estockreturn*	0.2891	0.5439	0.2135	0.4522	0.3216	0.5305	0.2942	0.6242
*Top*1	0.4711	0.1806	0.4908	0.1761	0.5116	0.1667	0.3871	0.1798
*Top*2	0.0765	0.0810	0.0553	0.0648	0.0698	0.0868	0.1046	0.0752
$CapExp_t^{kw}$	0.1167	0.0781	0.1181	0.0688	0.1148	0.0795	0.1188	0.0830
$Debt_t^{kw}$	0.1459	0.1682	0.0272	0.0829	0.0278	0.0805	0.0446	0.0815
$Cash_t^{kw}$	0.0930	0.0897	0.0811	0.0731	0.0841	0.0819	0.1107	0.0896
RPT_t^{kw}	0.1089	0.1459	0.0776	0.1135	0.1260	0.1555	0.1047	0.1482
$Size^{kw}$	21.3433	0.9204	21.3718	1.0232	21.3582	0.9264	21.2956	0.8236
$Sales^{kw}$	0.0919	0.0415	0.0873	0.0381	0.0933	0.0463	0.0933	0.0348
$Othersources^{kw}$	0.3334	0.1706	0.3439	0.1534	0.3085	0.1701	0.3682	0.1788
$USE^{General-kw}$	0.2031	0.1996	0.1931	0.2040	0.2159	0.1974	0.1893	0.1999
$\Delta USE^{General-kw}$	0.0193	0.0257	0.0177	0.0243	0.0205	0.0263	0.0186	0.0258
Obs.	533	533	121	121	259	259	153	153

Notes:

(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*

(2) Explanation of variables:

Size and $Size^{kw}$: Firm size, which is measured by the natural log of the firm's total assets

Sales: Firm's sales growth, which is measured by the annual growth rate of sales

Leverage: Firm's leverage, which is measured by the ratio of total debt to total assets of the firm

Pr*estockreturn*: Pre-issue stock returns, which is measured by the 12 months stock returns of the firm's shares before SEOs.

Topi: Ownership of the largest $i-th$ shareholder, which is measured by the ratio of shares held by the largest $i-th$ shareholder to total shares of the firm

$CapExp_t^{kw}$: Changes in capital expenditures, which is the log of one plus the accumulation of capital expenditures from the year the firm issues SEOs up to three years subsequent to SEOs, normalized by prior issue total assets, i.e., $CapExp^{kw} = \ln(\frac{\sum_{i=0}^{t} CapExp}{TA_{t-1}} + 1)$

$Debt_t^{kw}$: Changes in firm's borrowing, which is measured by the log of one plus the change in the firm's total debt normalized by prior issue total assets, i.e., $Debt^{kw} = \ln(\frac{Debt_t - Debt_{t-1}}{TA_{t-1}} + 1)$

$Cash_t^{kw}$: Changes in cash stock, which is measured by the log of one plus the change in the firm's cash stock (*Cash*) scaled by the firm's prior issue total assets, i.e. $Cash^{kw} = \ln(\frac{Cash_t - Cash_{t-1}}{TA_{t-1}} + 1)$

RPT_t^{kw}: Changes in related party transaction, which is measured by the log of one plus the change in the volume of related party transaction normalized by prior issue total assets, i.e., $RPT^{kw} = \ln(\frac{RPT_t - RPT_{t-1}}{TA_{t-1}} + 1)$.

$Sales^{kw}$: Changes in sales, which is measured by log of one plus the change in sales normalized by prior issue total assets, i.e. $Sales^{kw} = \ln(\frac{(Sales_t - Sales_{t-1})}{TA_{t-1}} + 1)$

$Othersources^{kw}$: Other sources of funds excluding SEO proceeds, which is measured as the sum of net cash flow from operations, cash inflow from disinvestment, and cash inflow from financing activities excluding proceeds from the current SEOs, i.e. $Othersources^{kw} = \ln(\frac{\sum_{i=0}^{t} Othersources}{TA_{t-1}} + 1)$

$USE^{General-kw}$: Total amount of SEO proceeds in the category of corporate general purposes, which is measured by the log of one plus total SEO proceeds in the category of corporate general purposes scaled by prior issue total assets, i.e. $USE^{General-kw} = \ln(\frac{USE^{General}}{TA_{t-1}} + 1)$

$\Delta USE^{General-kw}$ Changes in total amount of SEO proceeds in the category of corporate general purposes, which is measured by the log of one plus change in SEO proceeds in the category of general corporate purposes scaled by prior issue total assets, i.e. $\Delta USE^{General-kw} = \ln(\frac{\Delta USE^{General}}{TA_{t-1}} + 1)$.

5. Empirical Results

5.1 Explaining changes in the use of unspecified SEO proceeds

Table 3 reports the results of estimating the empirical model (1) in which the dependent variable is the probability of having the dummy variable $Change$ =1 if the firm has increased SEO proceeds into the category of corporate general purposes, and $Change$ =0 otherwise. In Table 3a $Change$ =1 if $\Delta USE^{General} > 0$ and zero otherwise. As we can see from Table 3a, the estimated coefficient for firm size ($Size$) is negatively significant in columns (1), (2), (3), and (4), suggesting that larger firms are less likely to engage in the "bait and switch" tactic regarding the use of SEO proceeds. The estimated coefficient for sales ($Sales$) is negatively significant in columns (5) and (6) when the controlling shareholder of the issuing firm is a parent SOE, indicating that the firm changes the use of SEO proceeds in the direction opposite to sales growth of the firm. In another word, the firm does not change the use of SEO proceeds because of the change in the firm's sales growth. The estimated coefficient for leverage ($Leverage$) is not significant in explaining the change in unspecified SEO proceeds. One clear-cut and important result shown in Table 3a concerns the firm's pre-issue stock market returns ($\Pr eStock \operatorname{Re} turn$). The estimated coefficient for $\Pr eStock \operatorname{Re} turn$ is highly positively significant in all but one estimated equations in Table 3a. This result strongly suggests that sample firms issue SEOs clearly driven by the market timing motive. When the firm's pre-issue stock market returns are high (which means that the firm is likely to be overvalued by the stock market), firms rush to the stock market to raise equity capital via SEOs by promising shareholders to conduct new investment, the proceeds of which are then switched to the unspecified use in the category of corporate general purposes. This is consistent with the "bait and switch" tactic. As we mentioned earlier, since we examine the "bait and switch" behavior regarding the use of SEO proceeds, the most suspicious explanatory factor concerns the controlling shareholder of the issuing firm. This is because the conflict between controlling shareholders and minority shareholders is severe in Chinese listed firms (e.g. Jiang et al., 2010; Berkman et al., 2010). Therefore, we examine whether or not the controlling shareholder ($Top1$) is involved in the decision of changing the use of SEO proceeds. As it is

shown in Table 3a, the estimated coefficient for the controlling shareholder's ownership $(Top1)$ is highly positively significant in 6 out of 8 cases. The result clearly confirms that the controlling shareholder is indeed important in making the "bait and switch" decision. The higher the ownership held by the controlling shareholder $(Top1)$, the more likely it is for the firm to put more SEO proceeds into the category of corporate general purposes after SEOs. Adding the 2nd largest shareholder's ownership into the estimation does not change the nature of the result concerning the controlling shareholder.

In Table 3b we check the robustness of the results shown in Table 3a by defining $Change =1$ if $\Delta USE^{General} Ratio > 0$. Here $USE^{General} Ratio$ refers to the ratio of SEO proceeds in the category of corporate general purposes to total SEO proceeds, hence $\Delta USE^{General} Ratio =$Realized $\left(USE^{General}/Total\,procceds\right)$ - $Planned\left(USE^{General}/Total\,procceds\right)$. The results shown in Table 3b are very consistent with that in Table 3a. Therefore, no matter how we measure the changes in unspecified SEO proceeds for corporate general purposes, two clear-cut results remain. Firstly, the sample firms are strongly driven by the market timing motive for issuing SEOs, which is supported by the result concerning the firm's pre-issue stock market returns ($\Pr eStock\,Re\,turn$). The estimated coefficient for $\Pr eStock\,Re\,turn$ is highly positively significant in 6 out of 8 estimated equations in Table 3b. Secondly, once again, we obtain from Table 3b that the higher the ownership held by the controlling shareholder $(Top1)$, the more likely it is for the firm to put more SEO proceeds into the category of corporate general purposes after SEOs. This result particularly applies to the firms in which either the state or parent SOEs are controlling shareholders of issuing firms.

Table 3a Explaining changes in the use of SEO proceeds: Change =1 if $\Delta USE^{General} > 0$

	Probit (Change =1)							
	Whole		Top1state		Top1soe		Top1others	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Size	-0.0664***	-0.0649***	-0.5725***	-0.6427**	0.0743	0.0691	0.0637	0.1701
	(-3.00)	(-2.75)	(-2.39)	(-2.22)	(1.12)	(0.98)	(0.40)	(0.97)
Sales	-0.1289	-0.1285	0.1486	0.0875	-0.3823*	-0.3983*	-0.1681	-0.0782
	(-1.08)	(-1.09)	(0.36)	(0.24)	(-1.75)	(-1.92)	(-0.70)	(-0.31)
Leverage	-0.2896	-0.2890	-0.6033	-1.1835	0.1256	0.1542	-0.1200	-0.5994
	(-0.62)	(-0.62)	(-0.62)	(-1.45)	(0.18)	(0.23)	(-0.23)	(-1.14)
Pr $estockreturn$	0.3268***	0.3235***	0.2760*	0.1927	0.4063***	0.3763***	0.3978***	0.4260***
	(3.92)	(3.74)	(1.69)	(1.63)	(3.04)	(3.06)	(2.60)	(3.14)
Top1	0.0072***	0.0081***	0.0191***	0.0096	0.0084***	0.0112***	0.0029	0.0095**
	(2.37)	(2.75)	(3.24)	(1.40)	(4.32)	(3.77)	(0.49)	(2.01)
Top2		0.0038		-0.0553**		0.0112		0.0399***
		(0.61)		(-2.00)		(1.54)		(6.41)
Pseudo R^2	0.3786	0.3788	0.3428	0.3828	0.2508	0.2537	0.1449	0.1689
Observations	513	513	109	109	234	234	122	122

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level.
(5) See notes to Table 2 for explanations of variables

Table 3b Explaining changes in the use of SEO proceeds: Change =1 if $\Delta USE^{General} Ratio > 0$

	Probit (Change =1)							
	Whole		Top1state		Top1soe		Top1others	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Size	-0.1391***	-0.1344***	-0.5104*	-0.5704*	-0.0349	-0.0385	-0.0351	0.0192
	(-5.79)	(-5.60)	(-1.79)	(-1.73)	(-0.52)	(-0.55)	(-0.20)	(0.11)
Sales	0.0345	0.0318	0.5677	0.5311	-0.1521	-0.1931	-0.1043	-0.0243
	(0.41)	(0.38)	(1.38)	(1.27)	(-0.84)	(-1.17)	(-0.48)	(-0.10)
Leverage	0.2339	0.2449	-0.3725	-0.8567	0.7217	0.7213	0.1170	0.0015
	(0.51)	(0.52)	(-0.30)	(-0.92)	(1.33)	(1.37)	(0.17)	(0.01)
Pr $estockreturn$	0.1946***	0.1901***	0.4205***	0.3607***	0.2952***	0.2604***	0.0343	0.0609
	(3.12)	(3.05)	(3.98)	(2.91)	(3.21)	(3.11)	(0.28)	(0.49)
Top1	0.0077***	0.0099***	0.0203***	0.0125**	0.0093***	0.0133***	0.0051	0.0114***
	(2.87)	(3.96)	(3.89)	(1.98)	(3.63)	(3.82)	(1.15)	(3.92)
Top2		0.0103		-0.0462*		0.0180*		0.0314***
		(1.43)		(-1.71)		(1.91)		(3.47)
Pseudo R^2	0.1113	0.1138	0.2172	0.2489	0.1087	0.1171	0.1161	0.1328
Observations	513	513	109	109	250	250	140	140

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level.
(5) See notes to Table 2 for explanations of variables

In sum, the results shown in both Tables 3a and 3b are consistent with the explanation that Chinese SEOs are mainly driven by the market timing motive and the "bait and switch" behavior regarding the use of SEO proceeds is associated with the conflict between controlling shareholders and minority shareholders.

5.2 Explaining the use of unspecified SEO proceeds based on the whole sample

In this section we discuss the results of estimating the empirical model (3) to reveal how firms use unspecified SEO proceeds. As we discussed already in Section 4.2, we are interested in four variables: capital expenditures, debt, cash stock, and related party transactions. These four variables are used as dependent variables respectively in estimating the empirical model (3). According to the KW model, the dependent variable used in the estimation is constructed in the way that reflects the changes (or the accumulation) of the variable of concern (details see Section 4.2). The idea is to see whether or not the use of unspecified SEO proceeds in the category of corporate general purposes can explain the changes (or the accumulation) of the above-mentioned four variables up to 3 years after SEOs.

Tables 4a, 4b, 4c, and 4d report the results of estimating the empirical model (3) for the whole sample when capital expenditures $\left(CapExp^{kw}\right)$, debt $\left(Debt^{kw}\right)$, cash stock $\left(Cash^{kw}\right)$, and related party transactions $\left(RPT^{kw}\right)$ are the dependent variable, respectively. The first four columns in these tables report the results concerning how the firm uses the increased amount of unspecified SEO proceeds in the category of corporate general purposes, i.e. $\Delta USE^{general-kw}$, and the last four columns of these tables report the results concerning how the firm uses the total amount of unspecified SEO proceeds in the category of corporate general purposes, i.e. $USE^{general-kw}$. We follow the movement of each dependent variable from the SEO year (year t) to the following three years after SEOs. In the estimation when the dependent variable is in year $(t+i)$, where i =0, 1,2,3, the independent variables apart from $\Delta USE^{general-kw}$ or $USE^{general-kw}$ are the observations taken from year $(t+i-1)$. This way the result reveals whether unspecified SEO proceeds affect changes of the dependent variable of concern after controlling for other possible contributing factors.

Table 4a Use of unspecified SEO proceeds based on the whole sample: Capital expenditures

	$CapExp_t^{kw}$	$CapExp_{t+1}^{kw}$	$CapExp_{t+2}^{kw}$	$CapExp_{t+3}^{kw}$	$CapExp_t^{kw}$	$CapExp_{t+1}^{kw}$	$CapExp_{t+2}^{kw}$	$CapExp_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0021	-0.0091	-0.0077	-0.0006	0.0019	-0.0092	-0.0079	-0.0008
	(0.59)	(-1.48)	(-1.02)	(-0.06)	(0.52)	(-1.52)	(-1.05)	(-0.08)
$Sales^{kw}$	0.2680***	0.5575***	0.9318***	1.0593***	0.2683***	0.5541***	0.9282***	1.0537***
	(4.66)	(7.03)	(8.51)	(6.50)	(4.62)	(7.09)	(8.66)	(6.40)
$Othersources^{kw}$	0.1895***	0.3576***	0.3860***	0.3928***	0.1891***	0.3564***	0.3843***	0.3902***
	(17.40)	(17.86)	(18.12)	(24.29)	(17.23)	(17.63)	(18.22)	(25.41)
$\Delta USE^{General-kw}$	-0.2028*	-0.4432***	-0.5218***	-0.7958***				
	(-1.78)	(-3.68)	(-3.92)	(-3.89)				
$USE^{General-kw}$					-0.0402***	-0.0647***	-0.0759***	-0.1167***
					(-2.37)	(-2.92)	(-4.28)	(-4.45)
$F(p-value)$	49.03	217.31	371.18	2933.78	59.89	213.17	8998.32	1631.02
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.2130	0.3480	0.4074	0.3958	0.2176	0.2176	0.4084	0.3974
$Observations$	513	519	522	513	513	519	522	513

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level.
(5) See notes to Table 2 for explanations of variables

Table 4b Use of unspecified SEO proceeds based on the whole sample: Debt

	$Debt_t^{kw}$	$Debt_{t+1}^{kw}$	$Debt_{t+2}^{kw}$	$Debt_{t+3}^{kw}$	$Debt_t^{kw}$	$Debt_{t+1}^{kw}$	$Debt_{t+2}^{kw}$	$Debt_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0081***	-0.0022	-0.0081*	-0.0184***	0.0079***	-0.0025	-0.0084*	-0.0191***
	(2.85)	(-0.35)	(-1.66)	(-4.22)	(2.81)	(-0.39)	(-1.76)	(-4.38)
$Sales^{kw}$	0.0239	0.2399***	0.2754*	0.2156	0.0251	0.2404***	0.2758*	0.2139
	(0.40)	(2.73)	(1.70)	(1.28)	(0.41)	(2.75)	(1.67)	(1.26)
$Othersources^{kw}$	-0.0377*	0.1709***	0.2468***	0.3449***	-0.0378*	0.1691***	0.2447***	0.3416***
	(-1.93)	(6.91)	(7.78)	(18.44)	(-1.94)	(6.72)	(7.52)	(18.91)
$\Delta USE^{General-kw}$	-0.0034	-0.0945	-0.2529	-0.5902***				
	(-0.02)	(-0.44)	(-0.97)	(-2.54)				
$USE^{General-kw}$					-0.0094	-0.0286	-0.0551***	-0.1067***
					(-0.63)	(-1.29)	(-2.87)	(-6.11)
$F(p-value)$	152.75	19.98	187.72	535.15	192.74	18.54	257.03	784.90
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.0384	0.0825	0.1692	0.2715	0.0388	0.0837	0.1713	0.2748
$Observations$	515	517	517	512	515	517	517	512

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level.
(5) See notes to Table 2 for explanations of variables

Table 4c Use of unspecified SEO proceeds based on the whole sample: Cash holdings

	$Cash_t^{kw}$	$Cash_{t+1}^{kw}$	$Cash_{t+2}^{kw}$	$Cash_{t+3}^{kw}$	$Cash_t^{kw}$	$Cash_{t+1}^{kw}$	$Cash_{t+2}^{kw}$	$Cash_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	-0.0229***	-0.0190***	-0.0225***	-0.0158***	-0.0227***	-0.0189***	-0.0225***	-0.0158***
	(-8.89)	(-6.39)	(-4.73)	(-2.40)	(-8.48)	(-6.40)	(-4.77)	(-2.42)
$Sales^{kw}$	0.3819***	0.3579***	0.3539**	0.1764*	0.3790***	0.3580***	0.3541**	0.1773*
	(6.00)	(2.86)	(1.97)	(1.79)	(6.02)	(2.89)	(1.99)	(1.83)
$Othersources^{kw}$	0.1649***	0.0991***	0.1266***	0.1646***	0.1650***	0.0999***	0.1267***	0.1645***
	(17.33)	(5.55)	(8.41)	(14.01)	(17.41)	(5.51)	(8.49)	(14.32)
$\Delta USE^{General-kw}$	0.0314	0.0982	0.0424	0.0385				
	(0.36)	(0.77)	(0.24)	(0.20)				
$USE^{General-kw}$					0.0203**	0.0199	0.0067	0.0026
					(2.01)	(1.17)	(0.30)	(0.09)
$F(p-value)$	206.82	239.79	1199.68	1988.33	103.92	622.34	486.54	1049.16
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.2197	0.1394	0.1859	0.2183	0.2215	0.1403	0.1859	0.2183
$Observations$	511	515	521	509	511	515	521	509

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level.
(5) See notes to Table 2 for explanations of variables

Table 4d Use of unspecified SEO proceeds based on the whole sample: Related party transactions

	RPT_t^{kw}	RPT_{t+1}^{kw}	RPT_{t+2}^{kw}	RPT_{t+3}^{kw}	RPT_t^{kw}	RPT_{t+1}^{kw}	RPT_{t+2}^{kw}	RPT_{t+3}^{kw}
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0291***	0.0563***	0.0848***	0.0844***	0.0288***	0.0556***	0.0838***	0.0829***
	(3.36)	(5.52)	(5.41)	(2.66)	(3.40)	(5.59)	(5.51)	(2.66)
$Sales^{kw}$	0.1963	0.6211	0.9586***	1.1488*	0.2030	0.6350*	0.9824***	1.1909*
	(1.23)	(1.64)	(2.35)	(1.71)	(1.28)	(1.68)	(2.43)	(1.80)
$Othersources^{kw}$	-0.0403	-0.0231	0.0536**	0.1363***	-0.0407	-0.0266	0.0504**	0.1331***
	(-1.06)	(-0.95)	(2.20)	(4.08)	(-1.05)	(-1.09)	(2.26)	(4.12)
$\Delta USE^{General-kw}$	0.2245	0.7012***	1.3180***	2.1282***				
	(1.13)	(2.53)	(3.74)	(5.19)				
$USE^{General-kw}$					0.0024	0.0469	0.1031*	0.1779***
					(0.08)	(1.00)	(1.79)	(3.10)
$F(p-value)$	98.78	47.70	126.12	207.62	77.42	41.62	75.60	182.31
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.0695	0.0962	0.1082	0.1145	0.0682	0.0927	0.1028	0.1065
$Observations$	518	522	524	514	518	522	524	514

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

According to Table 4a, the estimated coefficient for sales ($Sales^{kw}$) is positively significant in all cases, suggesting that investment undertaken by the firm is driven by demand, which is consistent with the accelerator theory of investment (e.g. Jorgenson, 1971). The estimated coefficient for other sources of funds ($Othersources^{kw}$) is also highly and positively significant in explaining the movement of the firm's post-SEO capital expenditures, suggesting that new investment undertaken by sample firms after SEOs is financed by other sources of funds excluding SEO proceeds. More importantly for the purpose of the paper, the estimated coefficient for the use of unspecified SEO proceeds (either $\Delta USE^{General-kw}$ or $USE^{General-kw}$) is always negatively significant in all the estimated equations in Table 4a. This result suggests that sample firms do not use unspecified SEO proceeds on capital investment, instead the more unspecified SEO proceeds the firm holds, the smaller amount of capital expenditures the firm undertakes. The negative association between these two variables confirms our observation from the raw data (see Table 1) that many sample firms switch the use of SEO proceeds from what was planned for new investment to unspecified uses by putting more SEO proceeds into the category of corporate general purposes. It is likely that the firm describes the use of SEO proceeds by promising using them on new investment, but later after issuing SEOs, the firm switches the use from investment to corporate general purposes. This result confirms the "bait and switch" tactic.

Table 4b shows that the estimated coefficient for the change in the use of SEO proceeds for corporate general purposes $\left(\Delta USE^{General-kw} \right)$ is negatively significant in column (4). In addition, the estimated coefficient for total SEO proceeds for corporate general purposes $\left(USE^{General-kw} \right)$ is negatively significant in columns (7) and (8). These results provide some evidence (3 out of 8 cases) that sample firms may use some unspecified SEO proceeds on retiring debt. Table 4b also shows that in 4 out of 8 estimations (columns 2, 3, 6, and 7), the firm's sales is positively associated with changes in debt. In addition, Table 4b also shows that changes in the firm's debt after the SEOs issuance is mostly supported by other sources of funds excluding SEO proceeds, particularly in the years after the SEO year. The estimated result concerning the relationship between firm size and changes in debt is mixed.

According to Table 4c, there is in general no association between the use of unspecified SEO proceeds and the firm's cash stock up to 3 years after SEOs. Only in column (4) is the estimated coefficient for $USE^{General-kw}$ positively significant, which can be seen as a weak support to the notion that the firm uses unspecified SEO proceeds to stockpile cash as far as the whole sample is concerned. Regarding other control variables, the estimated coefficient for firm size is negatively significant in all the cases in Table 4c, suggesting that larger firms normally hold less cash than smaller firms do, which is in line with the theoretical prediction (e.g. Kim et al., 1998). The estimated coefficient for sales and that for other sources of funds are positively significant in all the estimated equations in Table 4c, respectively, which is also in line with the results reported in other tables.

We observe from Table 4d that the estimated coefficient for firm size is positively significant in all cases, suggesting that on average larger firms have a larger scale of related party transactions than smaller firms. The estimated coefficient for sales is positively significant in 5 out of 8 cases (columns 3,4,6,7, and 8), suggesting that the scale of related party transactions is also positively associated with sales. The estimated coefficient for other sources of funds is positively significant in columns 3, 4, 7, and 8, suggesting that these related party transactions are also financed by other sources of funds excluding SEO proceeds. More importantly for the purpose of the paper, the estimated coefficient for the use of unspecified SEO proceeds is highly positively significant in many cases in Table 4d (columns 2, 3, 4, 7, and 8). This result suggests that sample firms use unspecified SEO proceeds on related party transactions. This result is important. This is because in the existing literature the evidence on related party transactions and tunneling in Chinese listed firms is largely derived by examining intercorporate loans. Here we provide new evidence supporting that the use of SEO proceeds is another possible channel through which related party transactions and tunneling can be conducted.

To summarize the result concerning the whole sample, we observe that: (1) sample firms on average do not use unspecified SEO proceeds on capital investment, instead they switch some SEO proceeds planned to be used for investment to unspecified SEO proceeds under the name of corporate general purposes. (2) Weak evidence shows that sample firms might use some unspecified SEO proceeds

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on retiring debt. (3) There is very weak evidence in support of the notion that sample firms use unspecified SEO proceeds in stockpiling cash. (5) It is very likely that sample firms use unspecified SEO proceeds on related party transactions.

The above results are obtained based on the whole sample. If the firm's controlling shareholder is involved in the "bait and switch" tactic regarding the use of SEO proceeds (see results in Section 5.1), then we would expect that the results based on the whole sample to vary depending on the nature of the firm's controlling shareholder. In the following subsection, we discuss the results when the sample is split based on the nature of controlling shareholders.

5.3 Does the nature of controlling shareholders matter for the use of unspecified SEO proceeds?

Based on the results in Section 5.1, we see that the controlling shareholder of the firm is associated with whether or not the firm changes the use of SEO proceeds by putting more proceeds in the category of corporate general purposes after issuing SEOs. The higher the ownership held by the controlling shareholder, the higher the likelihood it is for the firm to engage in the "bait and switch" tactic. In this section, we examine how the nature of controlling shareholders affects the use of unspecified SEO proceeds. Based on the available information on ownership structure for our sample firms, we split the sample into three subgroups according to the nature of controlling shareholders: (a) the controlling shareholder is the state ($Top1state$), (b) the controlling shareholder is a parent SOE ($Top1soe$), and (c) the controlling shareholders are other legal persons ($Top1others$). We repeat the estimations shown in Tables 4a, 4b, 4c, and 4d for the three subsample groups. The results are reported in Table 5, Table 6, and Table 7 for $Top1state$, $Top1soe$, and $Top1others$, respectively.

Table 5a Use of unspecified SEO proceeds based on $Top1state$ sample: Capital expenditures

	$CapExp_t^{kw}$	$CapExp_{t+1}^{kw}$	$CapExp_{t+2}^{kw}$	$CapExp_{t+3}^{kw}$	$CapExp_t^{kw}$	$CapExp_{t+1}^{kw}$	$CapExp_{t+2}^{kw}$	$CapExp_{t+3}^{kw}$

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0028 (1.13)	-0.0094 (-1.22)	-0.0101 (-1.03)	-0.0124 (-1.11)	0.0008 (0.33)	-0.0132* (-1.74)	-0.0134 (-1.47)	-0.0148 (-1.43)
$Sales^{kw}$	0.5355*** (3.78)	0.8419*** (4.42)	1.0238*** (3.75)	1.1482*** (3.87)	0.5366*** (3.89)	0.8382*** (4.77)	1.0233*** (3.89)	0.1310*** (3.93)
$Othersources^{kw}$	0.1408*** (4.21)	0.2801*** (3.39)	0.3142*** (2.97)	0.3690*** (4.45)	0.1471*** (4.54)	0.2776*** (3.38)	0.3131*** (2.96)	0.3704*** (4.52)
$\Delta USE^{General-kw}$	-0.6128** (-2.07)	-1.2350*** (-3.41)	-1.0391* (-1.90)	-1.5054*** (-2.51)				
$USE^{General-kw}$					-0.1125*** (-2.57)	-0.2101*** (-3.95)	-0.1824** (-2.32)	-0.2180*** (-2.69)
$F(p-value)$	161.89 (0.00)	1177.93 (0.00)	264.87 (0.00)	8590.19 (0.00)	519.00 (0.00)	1700.51 (0.00)	3941.55 (0.00)	2675.47 (0.00)
R^2	0.2153	0.2739	0.3236	0.3851	0.2596	0.3185	0.3464	0.3966
$Observations$	119	119	120	116	119	119	120	116

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Table 5b Use of unspecified SEO proceeds based on $Top1state$ sample: Debt

	$Debt_t^{kw}$	$Debt_{t+1}^{kw}$	$Debt_{t+2}^{kw}$	$Debt_{t+3}^{kw}$	$Debt_t^{kw}$	$Debt_{t+1}^{kw}$	$Debt_{t+2}^{kw}$	$Debt_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0175*** (3.70)	0.0079 (0.66)	0.0048 (0.66)	-0.0139* (-1.88)	0.0181*** (3.89)	0.0079 (0.60)	0.0051 (0.70)	-0.0132* (-1.76)
$Sales^{kw}$	0.1598 (1.48)	0.3787*** (2.35)	0.1270 (1.15)	-0.1431 (-0.58)	0.1614 (1.48)	0.3741*** (2.33)	0.1378 (1.04)	-0.1415 (-0.59)
$Othersources^{kw}$	0.0012 (0.05)	0.1145*** (3.38)	0.2012** (2.25)	0.3080*** (3.07)	-0.0005 (-0.02)	0.1145*** (3.35)	0.2003** (2.23)	0.3078*** (3.05)
$\Delta USE^{General-kw}$	0.1786 (0.85)	0.0168 (0.43)	0.3751 (0.86)	0.2128 (0.42)				
$USE^{General-kw}$					0.0304 (0.98)	-0.0111 (-0.18)	0.0411 (0.95)	0.0354 (0.84)
$F(p-value)$	63.91 (0.00)	179.37 (0.00)	1301.75 (0.00)	234.14 (0.00)	89.88 (0.00)	74.48 (0.00)	215.90 (0.00)	238.87 (0.00)
R^2	0.0740	0.0721	0.1009	0.2217	0.0759	0.0718	0.1003	0.2221
$Observations$	119	118	120	117	119	118	120	117

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Table 5c Use of unspecified SEO proceeds based on $Top1state$ **sample: Cash holdings**

	$Cash_t^{kw}$	$Cash_{t+1}^{kw}$	$Cash_{t+2}^{kw}$	$Cash_{t+3}^{kw}$	$Cash_t^{kw}$	$Cash_{t+1}^{kw}$	$Cash_{t+2}^{kw}$	$Cash_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	-0.0191***	-0.0139***	-0.0109*	-0.0192***	-0.0176***	-0.0116***	-0.0078	-0.0174***
	(-4.73)	(-4.36)	(-1.94)	(-3.81)	(-4.52)	(-3.44)	(-1.30)	(-3.23)
$Sales^{kw}$	0.1973***	0.1634***	0.1287	0.0967	0.1884***	0.1660**	0.1116	0.0829
	(2.92)	(2.37)	(0.60)	(0.90)	(2.69)	(2.31)	(0.49)	(0.73)
$Othersources^{kw}$	0.1981***	0.0743**	0.0610	0.1092***	0.1911***	0.0741***	0.0613	0.1086**
	(6.62)	(2.22)	(1.22)	(2.35)	(5.89)	(2.35)	(1.27)	(2.31)
$\Delta USE^{General-kw}$	0.1763	0.5889**	0.5064*	0.2397				
	(0.79)	(2.20)	(1.80)	(0.78)				
$USE^{General-kw}$					0.0615*	0.1066***	0.1302***	0.0751**
					(1.80)	(2.77)	(4.03)	(2.03)
$F(p-value)$	760.95	29.93	4148.83	143.84	2063.86	31.55	2041.41	118.49
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.2964	0.1465	0.1140	0.1296	0.3151	0.1742	0.1545	0.1396
$Observations$	118	117	120	117	118	117	120	117

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Table 5d Use of unspecified SEO proceeds based on $Top1state$ **sample: Related party transaction**

	RPT_t^{kw}	RPT_{t+1}^{kw}	RPT_{t+2}^{kw}	RPT_{t+3}^{kw}	RPT_t^{kw}	RPT_{t+1}^{kw}	RPT_{t+2}^{kw}	RPT_{t+3}^{kw}
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0422***	0.0798***	0.1092***	0.1295***	0.0432***	0.0816***	0.1140***	0.1342***
	(5.65)	(6.17)	(7.16)	(5.78)	(6.10)	(6.20)	(11.20)	(5.75)
$Sales^{kw}$	0.3823***	1.1716***	1.5546***	1.8971***	0.3625***	1.126***9	1.5413***	1.8327***
	(3.42)	(3.23)	(3.15)	(2.63)	(3.24)	(3.08)	(3.15)	(2.56)
$Othersources^{kw}$	0.1144***	0.1505***	0.1461**	0.1751**	0.1084***	0.1514***	0.1528***	0.1760**
	(4.66)	(2.87)	(2.12)	(2.18)	(4.67)	(2.74)	(2.37)	(2.03)
$\Delta USE^{General-kw}$	-0.2140	-0.6431	-0.1881	-0.2360				
	(-0.59)	(-1.53)	(-0.35)	(-0.36)				
$USE^{General-kw}$					0.0111	-0.0073	0.0477	0.1086
					(0.23)	(-0.13)	(0.63)	(1.36)
$F(p-value)$	2565.24	375.24	1969.40	14796.73	397.01	525.31	82.04	3242.70
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.2130	0.2503	0.2550	0.2538	0.2116	0.2459	0.2549	0.2563
$Observations$	120	120	121	120	120	120	121	120

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Tables 5a, 5b, 5c, and 5d report the results of estimating the empirical model (3) for $Top1state$ firms when capital expenditures, debt, cash stock, and related party transactions are the dependent variable, respectively. The estimated results concerning other control variables are mostly in line with what we obtained in Table 4 for the whole sample. We here focus on the estimated results regarding the

use of unspecified SEO proceeds. From Table 5 we observe the followings: (1) the estimated coefficient for the use of unspecified SEO proceeds is always negatively significant in all cases in Table 5a, which is consistent with the corresponding result for the whole sample. This result confirms that firms on average do not use unspecified SEO proceeds on capital investment, instead the more unspecified SEO proceeds the firm holds, the smaller amount of capital expenditures the firm undertakes, which suggests that firms switch some proceeds planned to be used for investment to unspecified SEO proceeds in the category of corporate general purposes. (2) Table 5b provides evidence that the state-controlled firms do not use unspecified SEO proceeds to retire debt. (3) According to Table 5c, the estimated coefficient for the use of proceeds is highly positively significant in 6 out of 8 cases, providing clear-cut evidence that the state-controlled firms use unspecified SEO proceeds on stockpiling cash. (4) Table 5d shows that the state-controlled firms do not use unspecified SEO proceeds on related party transactions. This result is consistent with Jiang et al (2010) who also document that the incentives for tunneling are greater among non-state controlled firms than the state-controlled firms.

In sum, Table 5 shows that the firms that have the state as the controlling shareholder are more likely to issue SEOs driven by the market timing motive and they use these unspecified SEO proceeds on stockpiling cash (see Table 5c). This result has a couple of implications. Firstly, it provides further evidence that the state-controlled listed firms are driven by the market timing motive when issuing SEOs. Kim and Weisbach (2008) document that the firms that really time the market will stockpile cash after SEOs. The result in Table 5c is consistent with the result shown in Tables 3a and 3b regarding the estimated result for the firm's pre-issue stock market returns when the whole sample is concerned. When the firm's pre-issue stock market returns are high (which means that the firm is likely to be overvalued by the stock market), firms rush to the stock market to raise equity capital via SEOs, the proceeds of which are then used to stockpile cash. Secondly, The result in Table 5c can also be linked to features of the Chinese financial system. It is widely documented that the combination of the state-controlled financial system and the state-dominated listed sector suggests that formal financing channels, including bank loans and stock markets, are mainly made available to large state-connected enterprises (e.g. Allen et. al. 2005).

Therefore, these state-controlled firms take that advantage of having access to the Chinese capital markets and raise as much as capital as they can, these proceeds are used to build up cash stock. These cash stock may be then used for other off-business activities. For example, according to the World Bank Report China 2030 (see World Bank, 2012), the state-dominated financial system and the state-dominated corporate sector in China suggest that many state-owned enterprises that can keep their earnings and have access to cheaper financing often operate outside their mandated areas by e.g. investing in real estate and the shadow banking system.

Table 6a Use of unspecified SEO proceeds based on *Top1soe* **sample: Capital expenditures**

	$CapExp_t^{kw}$	$CapExp_{t+1}^{kw}$	$CapExp_{t+2}^{kw}$	$CapExp_{t+3}^{kw}$	$CapExp_t^{kw}$	$CapExp_{t+1}^{kw}$	$CapExp_{t+2}^{kw}$	$CapExp_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	-0.0034 (-0.55)	-0.0137 (-1.44)	-0.0109 (-1.01)	-0.0034 (-0.23)	-0.0036 (-0.61)	-0.0139 (-1.51)	-0.0109 (-1.03)	-0.0036 (-0.24)
$Sales^{kw}$	0.1176 (0.97)	0.4332** (2.32)	0.8818*** (4.55)	1.0717*** (5.45)	0.1230 (1.01)	0.4348** (2.30)	0.8804*** (4.50)	1.0731*** (5.33)
$Othersources^{kw}$	0.1991*** (12.66)	0.3581*** (12.35)	0.3684*** (17.80)	0.3793*** (17.38)	0.1983*** (12.72)	0.3570*** (12.01)	0.3677*** (17.34)	0.3782*** (18.01)
$\Delta USE^{General-kw}$	0.1759 (1.00)	-0.0363* (-1.68)	-0.2343 (-1.16)	-0.2572 (-0.86)				
$USE^{General-kw}$					0.0102 (0.38)	-0.0158 (-0.43)	-0.0380 (-1.11)	-0.0524 (-1.14)
$F(p-value)$	65.53 (0.00)	113.59 (0.00)	545.57 (0.00)	546.27 (0.00)	81.06 (0.00)	117.87 (0.00)	269.75 (0.00)	270.84 (0.00)
R^2	0.2232	0.3367	0.4027	0.3579	0.2208	0.3371	0.4031	0.3591
Observations	253	255	256	252	253	255	256	252

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Table 6b Use of unspecified SEO proceeds based on *Top1soe* **sample: Debt**

	$Debt_t^{kw}$	$Debt_{t+1}^{kw}$	$Debt_{t+2}^{kw}$	$Debt_{t+3}^{kw}$	$Debt_t^{kw}$	$Debt_{t+1}^{kw}$	$Debt_{t+2}^{kw}$	$Debt_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0058 (1.52)	-0.0056 (-1.01)	-0.0102 (-1.33)	-0.0181** (-2.17)	0.0056 (1.41)	-0.0059 (-1.11)	-0.0104 (-1.37)	-0.0208*** (-2.43)
$Sales^{kw}$	-0.0579 (-0.45)	0.1999 (1.57)	0.3908 (1.32)	0.5074 (1.60)	-0.0558 (-0.44)	0.1949 (1.56)	0.3863 (1.29)	0.5288* (1.72)
$Othersources^{kw}$	-0.0747*** (-3.09)	0.1021*** (3.57)	0.2131*** (10.31)	0.3233*** (10.18)	-0.0759*** (-3.15)	0.0981*** (3.38)	0.2095*** (9.95)	0.3217*** (9.92)
$\Delta USE^{General-kw}$	-0.1156 (-0.61)	-0.4153** (-2.25)	-0.6821** (-2.21)	-0.8798*** (-3.28)				
$USE^{General-kw}$					-0.0360 (-1.36)	-0.0862*** (-2.85)	-0.1294*** (-3.02)	-0.1543*** (-4.52)
$F(p-value)$	5.76 (0.00)	8.63 (0.00)	796.85 (0.00)	148.88 (0.00)	5.82 (0.00)	7.14 (0.00)	565.82 (0.00)	335.49 (0.00)
R^2	0.0496	0.0534	0.1596	0.2554	0.0546	0.0615	0.1687	0.2680
Observations	252	253	252	251	252	253	252	251

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Table 6c Use of unspecified SEO proceeds based on *Top1soe* sample: Cash holdings

	$Cash_t^{kw}$	$Cash_{t+1}^{kw}$	$Cash_{t+2}^{kw}$	$Cash_{t+3}^{kw}$	$Cash_t^{kw}$	$Cash_{t+1}^{kw}$	$Cash_{t+2}^{kw}$	$Cash_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	-0.0141***	-0.0121***	-0.0173*	0.0028	-0.0138***	-0.0121***	-0.0173*	0.0026
	(-4.93)	(-2.98)	(-1.95)	(0.30)	(-4.74)	(-2.98)	(-1.95)	(0.28)
$Sales^{kw}$	0.4226***	0.4989***	0.3506**	0.0382	0.4171***	0.4953***	0.3495**	0.0437
	(5.22)	(3.70)	(2.02)	(0.17)	(5.02)	(3.69)	(2.07)	(0.20)
$Othersources^{kw}$	0.1592***	0.1031***	0.1184***	0.1435***	0.1601***	0.1025***	0.1175***	0.1432***
	(10.60)	(4.93)	(8.16)	(7.85)	(10.71)	(4.95)	(8.35)	(7.90)
$\Delta USE^{General-kw}$	-0.1450	-0.2618**	-0.1911	0.2215				
	(-0.97)	(-2.29)	(-0.65)	(0.69)				
$USE^{General-kw}$					-0.0072	-0.0391**	-0.0348	0.0220
					(-0.35)	(-2.10)	(-0.87)	(0.45)
$F(p-value)$	48.12	57.64	114.80	212.97	39.34	83.30	164.93	252.39
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.1891	0.1588	0.1898	0.1941	0.1876	0.1599	0.1913	0.1934
$Observations$	250	255	255	252	250	255	255	252

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Table 6d Use of unspecified SEO proceeds based on *Top1soe* sample: Related party transaction

	RPT_t^{kw}	RPT_{t+1}^{kw}	RPT_{t+2}^{kw}	RPT_{t+3}^{kw}	RPT_t^{kw}	RPT_{t+1}^{kw}	RPT_{t+2}^{kw}	RPT_{t+3}^{kw}
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0287***	0.0629***	0.0986***	0.0859**	0.0276***	0.0608***	0.0953***	0.0809**
	(3.68)	(5.04)	(4.87)	(2.03)	(3.42)	(4.67)	(4.60)	(1.94)
$Sales^{kw}$	0.1140	0.1663	0.2218	0.4513	0.1318	0.1982	0.2743	0.5486
	(0.53)	(0.47)	(0.62)	(0.71)	(0.63)	(0.57)	(0.78)	(0.88)
$Othersources^{kw}$	-0.1446***	-0.1143***	0.0458	0.1378***	-0.1470***	-0.1205***	0.0396	0.1295***
	(-3.86)	(-2.48)	(0.84)	(3.19)	(-3.85)	(-2.86)	(0.79)	(3.03)
$\Delta USE^{General-kw}$	0.5239	1.3094***	2.0556***	3.3684***				
	(1.61)	(2.80)	(3.75)	(3.74)				
$USE^{General-kw}$					0.0214	0.1025*	0.1478**	0.2617**
					(0.51)	(1.65)	(2.25)	(1.99)
$F(p-value)$	171.37	66.59	133.88	255.55	101.64	68.92	73.85	15.67
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.0780	0.0950	0.1192	.1147	0.0721	0.0847	0.1054	0.0934
$Observations$	255	256	257	250	255	256	257	250

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Tables 6a, 6b, 6c, and 6d report the results of estimating the empirical model (3) for firms that have parent SOEs as their controlling shareholders ($Top1soe$). For this group of firms, the result concerning both debt (Table 6b) and related party transactions (Table 6d) are important in terms of revealing the use of unspecified SEO proceeds. Table 6b shows that the estimated coefficient for the use of proceeds is negatively significant in 6 out 8 estimated equations, suggesting that this group of firms use unspecified SEO proceeds to retire debt. In addition, Table 6d shows that the estimated coefficient for the use of unspecified SEO proceeds is positively significant in 6 out of 8 cases, which clearly confirms that this group of firms use these unspecified SEO proceeds on related party transactions. Taken together, these results suggest that firms that have parent SOEs as their controlling shareholders spend unspecified SEO proceeds on both retiring debt and on related party transactions. This result logically leads to another question: whether or not are changes in the firm's debt position and changes in the scale of related party transactions related with each other? According to Jiang et al. (2010) parent SOEs in Chinese listed firms often tunnel assets away from listed firms via related party loans. More specifically, Jiang et al. (2010) investigate intercorporate loans of Chinese listed firm during 1996-2006. They report that a significant proportion of such loans can be traced directly to controlling shareholders or their affiliates. Most of these loans did not accrue interest, and even when some interest was accrued, neither the interest nor the principles was ever paid back. Jiang et al (2010) suggests that related-party loans are likely related to related party transactions between listed firms and their controlling shareholders. Our result shown in Table 6d is consistent with Jiang et al (2010). It suggests that this group of sample firms may use unspecified SEO proceeds as intercoporate loans directed to their parent SOEs, which reduces the net debt position of the issuing firms. Moreover, intercoporate loans are likely related to other types of related party transactions. Therefore, it is likely that parent SOEs, as controlling shareholders, manipulate the use of SEO proceeds raised by their listed firms in order to support tunneling activities. Our results for this group of firms can be seen as new evidence of exploitation of minority shareholders by controlling

shareholders. It suggests that in China conflicts between controlling shareholders and minority shareholders are particularly severer in listed firms that are controlled by their parent SOEs.

Table 7a Use of unspecified SEO proceeds based on $Top1others$ **sample: Capital expenditures**

	$CapExp_t^{kw}$	$CapExp_{t+1}^{kw}$	$CapExp_{t+2}^{kw}$	$CapExp_{t+3}^{kw}$	$CapExp_t^{kw}$	$CapExp_{t+1}^{kw}$	$CapExp_{t+2}^{kw}$	$CapExp_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0118 (0.67)	-0.0054 (-0.28)	-0.0069 (-0.35)	0.0053 (0.26)	0.0118 (0.68)	-0.0061 (-0.33)	-0.0071 (-0.37)	0.0051 (0.26)
$Sales^{kw}$	0.4374** (2.20)	0.6793*** (2.40)	0.9034** (2.23)	0.7379* (1.94)	0.4505** (2.21)	0.6912*** (2.47)	0.9161** (2.26)	0.7708** (1.97)
$Othersources^{kw}$	0.2159*** (11.77)	0.4147*** (10.53)	0.4578*** (11.09)	0.4288*** (9.18)	0.2153*** (12.32)	0.4223*** (10.34)	0.4615*** (11.33)	0.4248*** (10.15)
$\Delta USE^{General-kw}$	-0.5779*** (-4.11)	-0.4516*** (-3.06)	-0.4108 (-1.40)	-1.1190** (-2.27)				
$USE^{General-kw}$					-0.0696*** (-3.82)	-0.0119 (-0.48)	-0.0159 (-0.39)	-0.1273* (-1.93)
$F(p-value)$	1637.66 (0.00)	479.44 (0.00)	3187.36 (0.00)	499.11 (0.00)	3498.41 (0.00)	365.89 (0.00)	762.69 (0.00)	401.16 (0.00)
R^2	0.3243	0.4754	0.4970	0.4803	0.3139	0.4707	0.4950	0.4770
$Observations$	141	145	146	145	141	145	146	145

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Table 7b Use of unspecified SEO proceeds based on $Top1others$ **sample: Debt**

	$Debt_t^{kw}$	$Debt_{t+1}^{kw}$	$Debt_{t+2}^{kw}$	$Debt_{t+3}^{kw}$	$Debt_t^{kw}$	$Debt_{t+1}^{kw}$	$Debt_{t+2}^{kw}$	$Debt_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0018 (0.24)	-0.0189* (-1.69)	-0.0332*** (-2.66)	-0.0425*** (-2.67)	0.0018 (0.24)	-0.0188* (-1.74)	-0.0332*** (-2.72)	-0.0422*** (-2.62)
$Sales^{kw}$	-0.0006 (-0.00)	-0.0059 (-0.03)	-0.2271 (-1.06)	-0.5583** (-2.00)	-0.0017 (-0.01)	-0.0222 (-0.10)	-0.2294 (-1.06)	-0.5325** (-2.08)
$Othersources^{kw}$	-0.0306 (-0.86)	0.3016*** (6.22)	0.3119*** (8.58)	0.3707*** (8.22)	-0.0304 (-0.86)	0.3038*** (6.35)	0.3120*** (9.12)	0.3574*** (8.88)
$\Delta USE^{General-kw}$	0.0632 (0.28)	0.6770 (1.10)	0.0850 (0.14)	-0.7407 (-0.97)				
$USE^{General-kw}$					0.0093 (0.33)	0.0856 (1.38)	0.0090 (0.24)	-0.1572*** (-3.59)
$F(p-value)$	60.34 (0.00)	228.29 (0.00)	164.70 (0.00)	72.14 (0.00)	68.47 (0.00)	140.46 (0.00)	70.86 (0.00)	84.18 (0.00)
R^2	0.1208	0.2500	0.3107	0.3555	0.1209	0.2488	0.3106	0.3631
$Observations$	144	146	145	144	144	146	145	144

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Table 7c Use of unspecified SEO proceeds based on $Top1others$ sample: Cash holdings

	$Cash_t^{kw}$	$Cash_{t+1}^{kw}$	$Cash_{t+2}^{kw}$	$Cash_{t+3}^{kw}$	$Cash_t^{kw}$	$Cash_{t+1}^{kw}$	$Cash_{t+2}^{kw}$	$Cash_{t+3}^{kw}$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	-0.0426***	-0.0415***	-0.0464***	-0.0447***	-0.0425***	-0.0416***	-0.0463***	-0.0447***
	(-5.84)	(-4.03)	(-4.82)	(-4.07)	(-5.81)	(-4.07)	(-4.88)	(-4.04)
$Sales^{kw}$	0.2573	-0.0714	0.2298	0.2008	0.2514	-0.0805	0.2224	0.2072
	(1.07)	(-0.35)	(0.79)	(0.82)	(1.04)	(-0.40)	(0.76)	(0.86)
$Othersources^{kw}$	0.1254***	0.1068**	0.1709***	0.2115***	0.1256***	0.1103**	0.1687***	0.2075***
	(7.10)	(2.22)	(5.60)	(6.37)	(7.35)	(2.04)	(5.05)	(5.89)
$\Delta USE^{General-kw}$	0.2801	0.3823	0.2299	-0.2029				
	(1.53)	(1.47)	(1.58)	(-0.48)				
$USE^{General-kw}$					0.0392*	0.0599	0.0085	-0.0462
					(1.67)	(1.40)	(0.33)	(-0.80)
$F(p-value)$	32.31	157.37	25.46	384.65	39.35	190.60	92.15	406.13
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.2721	0.2038	0.2856	0.3410	0.2728	0.2071	0.2839	0.3426
$Observations$	143	143	146	140	143	143	146	140

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Table 7d Use of unspecified SEO proceeds based on $Top1others$ sample: Related party transaction

	RPT_t^{kw}	RPT_{t+1}^{kw}	RPT_{t+2}^{kw}	RPT_{t+3}^{kw}	RPT_t^{kw}	RPT_{t+1}^{kw}	RPT_{t+2}^{kw}	RPT_{t+3}^{kw}
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$Size^{kw}$	0.0265	0.0411	0.0724**	0.0782*	0.0267	0.0416	0.0728**	0.0779**
	(1.18)	(1.49)	(2.00)	(1.68)	(1.19)	(1.50)	(1.99)	(1.67)
$Sales^{kw}$	0.0558	1.0618**	2.4116***	2.1913***	0.0553	1.0489**	2.3870***	2.1676***
	(0.32)	(2.20)	(7.75)	(3.96)	(0.34)	(2.20)	(7.44)	(3.78)
$Othersources^{kw}$	0.0861***	0.0674*	0.0602**	0.1394***	0.0835***	0.0586	0.0547	0.1312***
	(2.56)	(1.85)	(2.06)	(3.17)	(2.35)	(1.54)	(1.46)	(2.59)
$\Delta USE^{General-kw}$	-0.3163	0.3569	0.8009	0.7267				
	(-1.07)	(0.86)	(0.97)	(0.60)				
$USE^{General-kw}$					-0.0776*	-0.0143	0.0423	0.0088
					(-1.87)	(-0.21)	(0.33)	(0.05)
$F(p-value)$	64.86	12.52	44.01	156.10	70.98	11.32	57.14	74.66
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
R^2	0.0798	0.0757	0.1171	0.1340	0.0857	0.0746	0.1145	0.1325
$Observations$	143	146	146	144	143	146	146	144

Notes:
(1) Data source: China Centre for Economic Research (CCER) database *Sinofin*
(2) Standard errors are adjusted by industry-clusters
(3) t-statistics are reported in the bracket
(4) * significant at 10% level; ** significant at 5% level; *** significant at 1% level
(5) See notes to Table 2 for explanations of variables

Tables 7a, 7b, 7c, and 7d report the results of estimating the empirical model (3) for the firms in which other legal persons are controlling shareholders ($Top1others$). This set of result does not provide clear-cut evidence on how these firms use unspecified SEO proceeds apart from the result concerning capital expenditures. According to Table 7a, it is clear that these firms on average do not use unspecified SEO proceeds on capital investment, instead they switch some proceeds planned to be used for investment to unspecified SEO proceeds in the category of corporate general purposes. This result is consistent with the result regarding capital expenditures reported in other tables.

6. Conclusions

The literature identifies a few motives driving the firm's SEO decision, such as to finance new investment, to retire debt, to meet near-term need of cash, all of these are related to real and financial activities of the issuing firm. Besides these motives, firms may issue SEOs for reasons unrelated to the firm's real and financial activities. For example, a firm may issue SEOs to time the market or as a result of governance problems. Therefore, how firms uses SEO proceeds can reveal true motivations for issuing SEOs.

We observe that there exists a huge discrepancy between the planned use and the realized use of SEO proceeds in the Chinese corporate practice. Put it differently, firms promise potential investors to use SEO proceeds on new investment in their issue reports, but after SEOs are issued, many firms change the plan of using SEO proceeds. More specifically, we observe that many firms put more SEO proceeds into the category of corporate general purposes, while in the meantime they reduce the use of SEO proceeds on new investment. Because the use of SEO proceeds in the category of corporate general purposes is officially not specified, it provides the firm with a huge degree of discretion in deciding how to use these unspecified SEO proceeds. We refer to the above-mentioned conduct as the "bait and switch" tactic regarding the use of SEO proceeds. In this paper, we examine whether or not the controlling shareholder of the issue firm is involved in the change in the use of SEO proceeds and how firms ultimately use these unspecified SEO proceeds.

Using 533 SEOs during 1999-2006 we document that Chinese SEOs are mainly driven by the market timing motive and that controlling shareholders are involved in the "bait and switch" behavior

regarding the use of SEO proceeds. The higher the ownership held by the controlling shareholder, the higher the likelihood it is for the firm to engage in the "bait and switch" tactic. Our results show that the sample firms on average do not use unspecified SEO proceeds on capital investment, instead they switch from proceeds planned to be used for investment to unspecified SEO proceeds in the category of corporate general purposes. This result applies to firms regardless of the nature of the firm's controlling shareholders. We also find that the nature of the controlling shareholder does matter for the use of SEO proceeds on other activities rather than capital investment. More specifically, the state-controlled firms raise equity capital via SEOs mainly driven by the market timing motive and they use SEO proceeds to stockpile cash. The firms that are controlled by parent SOEs use unspecified SEO proceeds to repay debt and to support related party transactions. Based on the evidence documented in previous studies, these two types of activities are related to parent SOEs (e.g. Jiang et al. 2010). If this is the case, then these firms change the use of SEO proceeds for the purpose of supporting tunneling activities undertaken by controlling shareholders. However, for the firms in which other legal persons are controlling shareholders, there is no clear-cut pattern about how these firms use unspecified SEOs proceeds expect that the SEO proceeds are not used for new investment.

Our research suggests that Chinese SEO market has been used by Chinese listed firms to time the market in order to collect SEO proceeds and then use them for non-investment purposes. Our research raises some questions on the efficiency of the Chinese stock market regarding the allocation of capital resources. Although it is widely documented that Chinese private Small and Medium Enterprises (SMEs) have hardly had any access to the stock market, the state-controlled firms have easy access to equity financing via SEOs because both the firm and the stock market regulator are state-connected. Our results show that the state-controlled firms time the market in issuing SEOs and then stockpile the proceeds as cash stock. These cash stock may then be used for other off-business activities (see World Bank, 2012). Our research also suggests that policy makers should pay close attention to the listed firms that are controlled by their parent SOEs because the problem of exploration of minority shareholders by controlling shareholders is particularly severe in these firms in China.

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