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The Impact of the Short Selling Mechanism on the Investment Efficiency of Small and Medium-sized Enterprises

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Abstract

This paper selects data on listed SMEs in A-share market from 2012 to 2022, and uses the empirical research method to explore and prove impact of short sales mechanism on the investment efficiency of enterprises. The short selling intensity and the difference-in-differences method are used as tools to measure the short selling mechanism, and the impact of the short selling mechanism on the investment efficiency of small and medium-sized enterprises under different internal governance levels is analyzed. Then, the robustness and heterogeneity analysis are carried out to analyze the role of the short selling mechanism in bull and bear markets. This paper finds that compared with enterprises that are not allowed to short sell, the investment efficiency of shortable enterprises improves after they are allowed to short sell. Furthermore, upon further refinement, it is found that how the short selling mechanism influences the investment efficiency within enterprises is more in curbing over-investment rather than under-investment. Furthermore, in contrast to enterprises boasting a high standard of internal governance, the short selling mechanism exerts a more pronounced impact on those with a defective internal governance structure, especially in terms of suppressing over-investment. Therefore, continuing to liberalize the securities lending business and improving its relevant systems can give full play to the corporate governance role of short selling in China's capital market.

Keywords

Short Selling Mechanism; Investment Efficiency; Small and Medium-sized Enterprises.

1. Introduction

In the context of the dynamic evolution of the institutional environment, the economic effects of the short selling mechanism have become a focal issue that has attracted continuous attention from both the academic and business communities. Currently, China's capital market exhibits dual structural characteristics: at the micro level, there are still regulatory gaps in the governance system of listed companies; at the macro level, the legal regulatory framework urgently needs systematic improvement. This mismatched pattern between institutional supply and market demand highlights the important practical significance of studying the short selling system. As a market-oriented constraint tool, the research on its correction mechanism for corporate behavior can provide a key breakthrough for optimizing the corporate governance ecosystem.

Efficient investment is crucial in driving the rapid growth and long - term development of enterprises. However, managers' actual investment often deviates from the optimal investment level, resulting in inefficient investment, which is manifested as over - investment and under - investment [1]. The academic community generally pays attention to various factors that cause inefficient investment in enterprises. Existing literature has found that from the perspective of the enterprises themselves, factors such as the internal governance structure of the enterprise,

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the management style, the customer concentration, and difficulties faced by enterprises in obtaining financing will all affect their investment efficiency. Nevertheless, research findings that take small and medium - sized enterprises as the research subject are scarce.The small and medium-sized enterprises referred to in this article include enterprises on the Growth Enterprise Market (GEM) and the Science and Technology Innovation Board (STAR Market), which have a series of characteristics such as small scale, emphasis on technological research and development, and limited financing channels. China's A-share transfer system for small and medium-sized enterprises (SMEs) to be listed in 2013-2022, and uses empirical research methods to explore and prove how the short selling mechanism influences the investment efficiency within enterprises.By using the difference-in-differences method to set up a measurement model of the short selling mechanism, this article analyzes and studies ramification of short selling impact of short-selling regimes in external institutions on the investment efficiency of enterprises. This article finds that the short selling mechanism will restrain the inefficient investment of SMEs, and further research shows that for small and medium-sized enterprises, this restraining effect is more reflected in restraining over-investment rather than under-investment.

2. Literature Review and Research Hypotheses

2.1. The Impact of the Short Selling Mechanism on the Investment Efficiency of Small and Medium-sized Enterprises

Jin Qinglu et al. (2015), based on theories such as the value of real options, pointed out that due to the existence of short selling deterrence, when listed companies eligible for securities lending face poor investment opportunities or make wrong investment decisions, investors tend to short sell the company, incorporating negative information into the stock price, thus forcing the management to adjust their decisions [2]. Moreover, the worse the company's operating performance is, the more significant the improvement effect of the margin trading mechanism on its investment decisions will be. Liu Yanxia and Qi Huaijin (2019) found that overconfident managers tend to exhibit characteristics of excessive blind expansion or under-investment, and the introduction of margin trading can restrain the degree of blind expansion or under-investment, thereby indirectly improving the investment efficiency of enterprises. Kang Wen and Liu Lizhen (2022) found that margin trading can significantly reduce the probability of over-investment in enterprises, and further research shows that this is mainly because margin trading restrains earnings management behavior and improves the effectiveness of the company's internal control. Zheng Panpan (2022) found through empirical research that short selling pressure can restrain the inefficient investment of enterprises by influencing the company's compensation system, thus exerting an indirect corporate governance effect.

In order to minimize the pressure caused by the short selling of its stocks to the company, an enterprise will take appropriate actions to regulate corporate behavior and reduce the possibility of the discovery of negative information about inefficient investment, which will stimulate the management. From the perspective of the management, the pressure exerted on the stock price by short selling transactions will not only increase the possibility of the company being maliciously acquired and threaten the job security of the management, but also lead to a decline in the market value of the stocks or options held by the management, directly reducing the wealth of the management [3]. At the same time, the existence of short selling threats makes enterprises tend to issue more stock option contracts to the management, more closely linking the interests of the management with those of the company, and alleviating over-investment and under-investment that lead to a decline in enterprise value. Consequently, the following hypothesis is proposed in this paper.:

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H0a: The short - selling mechanism curbs the inefficient investment carried out by small and medium - sized enterprises.

2.2. How Short Selling Affects the Investment Efficiency of Enterprises under Different Internal Governance Levels

Companies with a low level of internal governance tend to have more serious problems of inefficient investment. Short sellers can obtain more potential profits by digging up the negative information about the inefficient investment of such companies and short selling them. Such companies are more likely to be short sold. Therefore, compared with companies with a superior level of internal governance, companies with a low level of internal governance already have lower investment efficiency before they are allowed to be short sold, and short selling of securities on margin will play a greater role in improving investment efficiency in such companies [4]. In enterprises with weak governance structures, the problem of inefficient investment is often more prominent. This enables short sellers to obtain a higher profit margin by uncovering the negative information in their investment decisions, thus causing such companies to face stronger short selling risks. It is worth noting that such companies have shown an investment efficiency level significantly lower than that of enterprises with high-quality governance before the short - selling mechanism is activated. Owing to the presence of this pre - existing efficiency gap, the corrective impact of securities short - selling within the margin system on the investment behavior is especially pronounced in enterprises with feeble governance structures.The market short selling pressure not only accelerates the exposure of inefficient investment behavior, but also forces the management to optimize capital allocation decisions, thereby generating a stronger driving force for governance improvement [5]. Therefore, this paper puts forward the hypothesis:

H0b: Compared with enterprises with a high level of internal governance, for enterprises with a low level of internal governance, the short selling mechanism can improve the investment efficiency to a greater extent.

3. Research Design

3.1. Data Source and Sample Selection

A sample of A-share listed SMEs from 2012 to 2022 is selected for analysis, and a total of 11,881 sample observations are obtained. All financial data are sourced from the CSMAR Database, and the data on whether the enterprises are enlisted in the securities lending list are from the RESSET Database. The sample processing methods adopted in this paper are as follows: (1) Exclude financial enterprises; (2) Remove enterprises that have been labeled as ST or ST*; (3) Exclude enterprises with insufficient financial data during the sample detection period.

3.2. Variable Design and Model Specification

3.2.1. Measurement of the Short Selling Mechanism

Regarding the measurement of the short selling mechanism,first of all, in order to observe the changes in the information disclosure quality of the underlying companies before and after the securities lending pilot, this paper refers to Li Chuntao (2017) to construct an explanatory variable. The ratio of the outstanding quantity in securities lending (the amount of securities lent - the amount of securities repaid) to the market value of tradable shares (SSP) is used as the measurement index of the short selling intensity. The larger the SSP, the greater the short selling intensity. Model (1) is constructed.

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$$absinv_{i,t} = \alpha + \beta_1 SSP_{i,t} + \beta_2 + \beta_3 Size + \beta_4 Lev + \beta_5 ROE + \beta_6 Growth + \beta_7 Age + \beta_8 Boardsize + \beta_9 Ind + \beta_{10} First + \beta_{11} Duality + \beta_{12} State + Yeardummie + Industrydummies + \varepsilon_{i,t} \quad (1)$$

3.2.2. Measurement of Internal Governance Level

Table 1. Symbols, Definitions and Explanations of All Variables

Variable type	Symbol	Meaning	Description
Explained Variable	absinv	Magnitude of Ineffective investment	The absolute value of the residual in Model (1)
	over	Scale of Over-investment	The value when the residual in Model (1) is positive. The larger the value, the higher the degree of over - investment.
	under	Scale of Under-investment	The value when the residual in Model (1) is negative. The smaller the value, the higher the degree of under - investment.
Explanatory Variable	SSP	Short - selling Intensity	(Short - selling amount - Short - selling repayment amount) / Market value of tradable shares
	GL	Corporate Internal Governance Level	If the company's governance level within the industry exceeds the median, assign a value of 1; otherwise, assign a value of 0.
	Treat	Has it ever been added to the short - selling list?	If the company has ever been included in the short - selling list, take 1; otherwise, take 0.
	PostShort	Whether it is on the short - selling list in the observed year?	If the observed year is a year after the company was included in the margin - trading pilot, the value is taken as 1; otherwise, it is taken as 0.
control variable	lnasset	The natural logarithm of total market capitalization	Take the natural logarithm of the total assets at the end of the period
	Lev	Asset - liability ratio	Total Liabilities at the End of the Period / Total Assets at the End of the Period
	Fc	Net cash flow from operating activities	the difference between cash inflows from operating activities and cash outflows from operating activities
	Expen	Management expense ratio	Administrative Expenses / Operating Revenue
	ROA	Return on total assets	Net Profit / Total Asset Balance
	Opin	Type of audit opinion	If the audit opinion is a "standard unqualified opinion", assign a value of 1; otherwise, assign a value of 0.
	Duality	CEO duality	Whether the same individual acts as both the chairman of the board and the general manager. If they are the same person, assign a value of 1; if not, assign a value of 0.
	State	the property of the enterprise	If it is a state - owned enterprise, the value is 1; if it is a non - state - owned enterprise, the value is 0.
	Yeardummies	annual dummy variable	If the company is in the current year, assign a value of 1; otherwise, assign a value of 0.
	Industrydummies	industry dummy variable	If the company belongs to the relevant industry, assign a value of 1; otherwise, assign a value of 0.

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When constructing the evaluation system for the company's internal governance level (GL), referring to the analysis and treatment of Lin Yan (2020), the proportion of shares held by the largest shareholder, which has the largest impact among the 10 core governance indicators, is used as the variable to measure the enterprise's internal governance ability for research [6].

Moreover, this research paper takes into account the annual and industry fixed effects by implementing control measures.The specific definitions and explanations of the variables are shown in Table 1 below.

4. Analysis of the Regression Results

4.1. Descriptive Statistics of Main Variables

The descriptive statistics of the main explanatory variables, explained variables, and control variables are shown in Table 2 as follows.

Table 2. Descriptive Statistics of Main Variables

Variable	median	standard deviation	maximum value	minimum value
absinv	0.049	0.071	1.587	0
under	-0.039	0.044	0	-0.668
over	0.064	0.01	1.587	0
SSP	-3.782	13.375	132.735	-116.671
Treat	0.649	0.477	1	0
PostShort	0.114	0.351	1	0
GL	0.348	0.476	1	0
Duality	0.428	0.495	1	0
ROA	0.056	0.136	0.733	-4.599
Expen	1.758	124.599	13191.44	-0.111
State	0.073	0.260	1	0
Lev	0.320	0.194	1	0
Fc	1.80e+08	1.19e+09	6.12e+10	-8.28e+09
Opin	0.975	0.155	1	0
lnasset	21.448	0.893	27.122	17.879

By making a unified observation of the explained variables, it can be found that the maximum value of the original value of non-investment efficiency is 1.587, and the minimum value is -0.668. It can be seen that there is a large difference in the actual investment scale of the sample enterprises. The median of the explanatory variables is -3.782, and the standard deviation is 13.375. Respectively, the peak value is 132.735 and the trough value is -116.671.This indicates that there is a significant difference in the short-selling intensity among different sample enterprises. By observing the median and standard deviation of the asset-liability ratio, it can be found that there is a large gap in the asset-liability ratios of the sample enterprises. However, the median is within the appropriate range, indicating that, generally speaking, the sample companies have relatively strong solvency and development potential. In addition, the median of the audit opinions is 0.975, suggesting that the audit opinions of most sample companies in that year are "standard unqualified opinions".

4.2. Non-investment Efficiency of Enterprises and Short Selling

This paper first conducts a regression analysis of the explanatory variables and all control variables against the absolute value of the non-investment efficiency scale (absinv). As analyzed previously, inefficient investment can be divided into underinvestment and overinvestment. In

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order to further discuss the refined effect of the short-selling mechanism, this paper then simultaneously conducts regressions of the explanatory variables and all control variables against the scales of underinvestment and overinvestment respectively. The regression results are shown in Table 3. All the above regressions control for industry and year fixed effects.

Table 3. Regression Results Table

Variable	(1)	(2)	(3)
	absinv	over	under
SSP	-0.0008**	-0.0018***	-0.0003
	(-2.5732)	(-3.3931)	(-0.7792)
Duality	0.0023	0.0068	-0.0017
	(0.7103)	(1.0751)	(-0.5732)
ROA	0.0309*	0.0204	-0.0116
	(1.7730)	(0.6038)	(-0.6994)
Expen	-0.0099	-0.0032	0.0101
	(-0.5395)	(-0.0561)	(0.7012)
State	-0.0086*	-0.0227*	-0.0026
	(-1.6606)	(-1.8793)	(-0.5780)
Lev	0.0035	0.0023	0.0080
	(0.3635)	(0.1181)	(0.8810)
Fc	0.0000	0.0000	-0.0000
	(0.5709)	(1.0802)	(-0.0689)
Opin	-0.0040	0.0105	0.0135*
	(-0.4196)	(0.4721)	(1.6893)
lnasset	0.0007	-0.0006	-0.0012
	(0.3169)	(-0.1320)	(-0.6038)

Note: ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively (this applies to all regression tables in this paper).

Table 3 presents the regression results of the the ramification of short selling of securities on the investment efficiency of enterprises under the control of annual fixed effects and company fixed effects. In column (1), the coefficient of the key variable SSP is negative and statistically significant at the 5% level. In column (2), this coefficient is negative and reaches statistical significance at the more stringent 1% level. However, in column (3), the coefficient of the SSP variable is not statistically significant. This result verifies that compared with enterprises that are not allowed short selling, the investment efficiency of enterprises eligible for short selling has improved after they are permitted to engage in short selling. Moreover, upon further refinement, it turns out that in what way the short - selling mechanism affects the investment efficiency of enterprises is more evidently shown in checking overinvestment rather than in dealing with underinvestment.Once an enterprise is selected as the target of short selling of securities, in order to prevent short sellers from exposing and taking advantage of the negative information about its inefficient investment to conduct short selling, it will actively restrain its overinvestment behavior. This phenomenon indicates that as a market regulatory means, the short selling mechanism of securities effectively promotes the improvement of the investment efficiency of enterprises, and Hypothesis H0a is verified.

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4.3. The Short - selling Mechanism and Investment Efficiency under Different Levels of Internal Governance

We conduct regression analyses of the explanatory variable SSP on the explained variable respectively when GL = 0 and GL = 1 to study the impact of the short-selling mechanism on the investment efficiency of small and medium-sized enterprises under different levels of internal governance. The regression results are shown in Table 4. Columns (2), (4), and (6) represent enterprises with a low level of internal governance, while columns (1), (3), and (5) represent enterprises with a high level of internal governance. By comparing the results of the two situations, it can be found that in column (1), the coefficient of the main variable SSP exhibits a significant negative value at the 5% level. In columns (2), (3), and (4), the main variable SSP shows significant negative values at the 10% level. This result verifies that compared with enterprises not allowed for short selling, the investment efficiency of enterprises allowed for short selling has improved after being permitted to short sell. Furthermore, upon further refinement, it is found that the outcome of the short-selling mechanism on the investment efficiency of enterprises is more in curbing overinvestment rather than underinvestment. And through the comparison of the regression data of enterprises under different levels of internal governance, it is evident that when compared with enterprises featuring a high degree of internal governance, the short-selling mechanism has a stronger effect on enterprises with poorly developed internal governance, especially in terms of suppressing overinvestment. Since enterprises originally have a high governance standard, the principal-agent problem between shareholders and management is relatively rare, and the level of information asymmetry is likewise low.. Thus, the "governance effect" and "information effect" that the short - selling of securities mechanism generates have relatively minor contributions to the improvement of the investment efficiency of enterprises.

Table 4. Regression Results Table under Different Levels of Internal Governance

	(1)	(2)	(3)	(4)	(5)	(6)
	absinv		over		under	
	GL=1	GL=0	GL=1	GL=0	GL=1	GL=0
SSP	-0.0010**	-0.0007*	-0.0012*	-0.0023***	0.0002	-0.0004
	(-2.1182)	(-1.7940)	(-1.7534)	(-2.9925)	-0.3265	(-0.9169)
Duality	-0.0035	0.0027	0.0043	0.0095	0.0054	-0.0031
	(-0.6844)	-0.6531	-0.4511	-1.0923	-1.0771	(-0.8374)
ROA	0.0063	0.0287	0.0008	0.015	-0.0004	-0.0129
	-0.1631	-1.4036	-0.0105	-0.3797	(-0.0105)	(-0.6688)
Expen	-0.0477	-0.0031	0.0913	-0.0777	0.0717***	-0.0157
	(-1.5641)	(-0.1242)	-0.737	(-1.1065)	-2.8758	(-0.8112)
State	-0.0086	-0.0119*	-0.0341*	-0.0237	-0.002	0.001
	(-1.1045)	(-1.6891)	(-1.7495)	(-1.4921)	(-0.3021)	-0.1591
Lev	0.0196	-0.0022	0.0227	-0.0163	0.012	0.0039
	-1.1517	(-0.1848)	-0.6827	(-0.6655)	-0.71	-0.3554
Fc	0	0	0	0	0	0
	-1.2251	-0.1176	-0.9349	-0.4467	(-0.0192)	(-0.0220)
Opin	0.0009	-0.0075	0.0551	-0.0018	0.0252	0.0117
	-0.0356	(-0.7010)	-1.0776	(-0.0670)	-1.0135	-1.3579
lnasset	-0.002	0.0015	-0.0002	-0.0012	-0.0024	-0.0006
	(-0.5917)	-0.5118	(-0.0344)	(-0.1893)	(-0.7031)	(-0.2497)

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5. Robustness Test

5.1. Excluding the Years Affected by the COVID-19 Pandemic

The Chinese economy suffered a huge impact from the COVID-19 pandemic that burst forth at the end of 2019.The outbreak and spread of the COVID-19 pandemic led to restrictions on economic activities, with consumption, investment, and exports all being hit, which slowed down the growth rate of the Chinese economy. It triggered significant fluctuations in the financial market, increased the uncertainties in economic development, and also had a certain impact on the investment confidence of enterprises from multiple aspects, which might affect the investment efficiency of enterprises. Therefore, the data from 2019 to 2020 were excluded, and the regression analysis was carried out again, as shown in Table 5. It can be clearly seen that the coefficient of the crucial variable SSP shows a significant negative value at the 5% significance level in column (1), a significant negative value at the 1% significance level in column (2), and is not significant in column (3). This is consistent with the previous regression results and still supports Hypothesis H0a.

Table 5. Regression Results after Excluding Some Years

Variable	(1)	(2)	(3)
	absinv	over	under
SSP	0.0007**	0.0017***	0.0003
	(2.2417)	(3.0342)	(0.8319)
Duality	0.0010	0.0060	-0.0019
	(0.2683)	(0.7924)	(-0.5479)
ROA	0.0335	0.0384	-0.0100
	(1.3773)	(0.7274)	(-0.4632)
Expen	-0.0100	-0.0054	0.0148
	(-0.4865)	(-0.0802)	(0.9179)
State	-0.0129**	-0.0250	0.0007
	(-1.9906)	(-1.6308)	(0.1200)
Lev	0.0050	0.0136	0.0127
	(0.4228)	(0.5608)	(1.1664)
Fc	0.0000	0.0000	0.0000
	(0.3735)	(0.8916)	(0.0378)
Opin	0.0019	0.0284	0.0118
	(0.1320)	(0.7767)	(1.0305)
lnasset	0.0013	-0.0009	-0.0022
	(0.4999)	(-0.1796)	(-0.9623)

5.2. Replacing the Explanatory Variables by Combining with the Difference - In - Differences Method

This paper refers to the research of Bertrand and Mullainathan (2003) as well as Chu Jian and Fang Junxiong (2016), constructs a difference-in-differences (DID) model, and defines the dummy variables Treat and PostShort as follows: If a company has ever been included in the securities lending list, Treat is equal to 1, otherwise it is 0; if the observation year is a year after the company is included in the securities lending pilot program, PostShort takes the value of 1, otherwise it is 0. The interaction term of Treat and PostShort is constructed as a new explanatory variable to replace the original SSP, and other variables remain unchanged. Then the regression is carried out again, and the results are shown in Table 6. As can be observed, the coefficient of the primary variable SSP is significantly negative at the 5% significance level

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in column (1), significantly negative at the 10% significance level in column (2), and fails to reach significance in column (3).It is generally consistent with the previous regression results and still supports Hypothesis H0a.

Table 6. Regression Results after Replacing the Explanatory Variables

Variable	(1)	(2)	(3)
	absinv	over	under
TreatPostShort	-0.0067**	-0.0109*	0.0034
	(-2.4004)	(-1.7852)	(1.5519)
Duality	0.0021	0.0066	0.0006
	(1.0610)	(1.4673)	(0.3784)
ROA	0.0503***	0.0950***	-0.0190**
	(4.7448)	(3.4177)	(-2.4992)
Expen	0.0455***	0.0690**	-0.0378***
	(3.8177)	(2.0086)	(-4.6175)
State	-0.0076**	-0.0196**	-0.0013
	(-2.0628)	(-2.0928)	(-0.4994)
Lev	0.0081	0.0134	0.0024
	(1.2872)	(0.9331)	(0.5023)
Fc	0.0000	0.0000	-0.0000
	(1.0037)	(0.7366)	(-0.4242)
Opin	-0.0054	-0.0098	0.0079*
	(-0.8705)	(-0.5776)	(1.8372)
lnasset	0.0047***	0.0079**	-0.0006
	(3.1976)	(2.3433)	(-0.5758)

6. Conclusion

This paper selects the data of A-share listed SMEs from 2012 to 2022, and uses empirical research method to discuss and demonstrate in what way the short - selling mechanism affects the investment efficiency of enterprises.The short-selling intensity and the difference-in-differences method are used as tools to measure the short-selling mechanism, and the impact of the short-selling mechanism on the investment efficiency of small and medium-sized enterprises under different levels of internal governance is analyzed. Then, robustness and heterogeneity analyses are carried out to analyze the ramification of short selling mechanism in bull and bear markets. The research results of this paper show that: (1) Compared with enterprises that are not allowed to short sell, the investment efficiency of enterprises eligible for short selling has improved after they are permitted to do so. Moreover, upon further refinement, it is found that in what way the short - selling mechanism affects the investment efficiency of enterprises is more in curbing overinvestment rather than underinvestment; (2) Compared with enterprises with a high level of internal governance, the short-selling mechanism has a stronger effect on enterprises with meagerly effective internal governance, especially in terms of suppressing overinvestment.

Obviously, as an external market governance mechanism, the short selling of securities plays a restraining role in curbing the inefficient investment behavior of enterprises, which provides new evidence for the policy effectiveness of the margin trading and securities lending system. Therefore, we should unswervingly continue to improve and promote the development of the margin trading and securities lending system, expand its underlying scope, focus on selecting those enterprises with relatively weak internal governance levels as the targets of short selling

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of securities, and reduce relevant transaction costs to attract more investors who possess negative information to participate. In addition, we should actively encourage financial innovation and use the power of market mechanisms to regulate the behavior of enterprises, so as to optimize the resource allocation of enterprises.

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