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Financial Policy Competition Neutrality and Firms Real Cost of Financing

——An Empirical Study Based on A-share Listed Companies

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Response to Reviewers:	

Highlights

(1) We examine the relationship between competitive neutrality of financial policies and the real cost of financing for firms.
(2) We find that internal control quality plays a mediating role in the mechanism of action.
(3) Internal control quality reinforces this weakening effect.

Financial Policy Competition Neutrality and Firms Real Cost of Financing ——An Empirical Study Based on A-share Listed Companies

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1 Introduction

The problem of expensive financing for enterprises, particularly the high real cost of financing, has become the focus of academic attention and research. When firms reveal significant deficiencies in their internal controls, creditors diminish their ability to utilise their accounting metrics to measure the firm's solvency and instead increase the cost of debt capital (Zhao et al., 2023). However, as future economic developments tend to be more complex and uncertainty about the future profitability of firms increases, firms are willing to improve the quality of their internal controls in order to convey better quality information to demonstrate their willingness to share information about the firm's economic activities with banks and to reduce the uncertainty caused by asymmetric information, which, in turn, helps to reduce the cost of debt financing. In regions with varying levels of financial development, the transmission channels and effects of financial policies are more effective. Banks and other financial institutions are better equipped to communicate the policy objectives of the central bank. The financing channels and scale of enterprises are more limited, strengthening the financing constraints and significantly increasing the cost of debt financing for enterprises. High-quality internal control can help lower the cost of debt financing for enterprises (Kong, 2023). However, in the modern enterprise system of the separation of ownership and operation, due to the high-risk characteristics of financing and high cost and other practical problems, it can easily lead to an increase in the cost of enterprise financing. This double dilemma of not being able to effectively realize financing has not yet attracted enough attention from practical and theoretical circles. Therefore, how to realise the healthy and competitive development of enterprises from the perspective of reducing financing costs has become the focus of attention of all circles.

At present, the competitiveness of inter-enterprise financing has become a key issue of concern and research in the academic community, whilst competitive neutrality is an institutional arrangement used by the Government to determine the mechanism of market competition, emphasising the construction of a fair competition mechanism. However, as the main body of the credit market, commercial banks often have differences in credit implementation under financial policy, demonstrating non-competitive neutrality (Liu, 2023). With policy support and bank favouritism, state-owned enterprises (SOEs) have a greater advantage over private enterprises in terms of bank credit lines, debt financing costs and debt maturity structure. However, since the beginning of 2020, the new crown pneumonia epidemic, an unexpected public health event, has had a huge impact on the production and operation of China's real enterprises. The huge impact of the New Crown Pneumonia epidemic provides a good exogenous experimental scenario that pushes the competitive neutrality of financial policy to a hot topic (Zhang et al., 2019). However, for the

stimulating effect of promoting financing that financial policy's competitive neutrality has, existing research lacks in-depth exploration. Compared with investment, real financing costs are more obviously affected by micro-enterprise financial conditions and macroeconomic policies. On the one hand, compared to investment projects, the actual financing capital is large and the investment period is long, so enterprises will face higher fixed costs for actual financing, which requires strong financing ability. When the enterprise faces financing constraints and its initial capital is not enough to pay the fixed costs, the enterprise cannot carry out direct financing behaviour; on the other hand, due to the lack of credit guarantee in the investing country and the operation of enterprises in the country of greater risk, direct financing of enterprises is also difficult to obtain favourable financial support. Under China's special institutional background, macro policies, especially financial policies, have an extremely far-reaching impact on enterprises, and they further influence their financing and investment decisions by changing their investment and financing environments and their risk-taking. However, the question of whether such a competitively neutral mechanism actually contributes to lowering the actual cost of financing, and whether and how a higher quality of internal control significantly guides firms to finance efficiently, have rarely been addressed. In view of this, this paper provides a systematic framework of financial policy competitive neutrality, internal control quality and real financing costs based on the internal control quality perspective, which leads to more convincing conclusions and enriches the research results in this area.

The marginal contributions of this paper include: firstly, exploring the breakthrough path to reduce the actual financing cost from the perspective of financial policy competition neutrality, analysing its mechanism, and enriching the existing research on financing cost; secondly, based on the perspective of internal control quality, introducing the "quality of internal control", and constructing the "financial policy competition neutrality - quality of internal control - quality of internal control". Secondly, based on the perspective of internal control quality, we introduce "internal control quality" and construct the basic theoretical framework of "financial policy competition neutrality - internal control quality - actual financing cost", which expands the theoretical content and research boundaries of "financial competition → financing dilemma"; thirdly, we provide an opportunity for national government departments to pay sufficient attention to financial policy competition neutrality and analyse its functioning mechanism. Thirdly, it provides a theoretical basis and practical guidance for national government departments to pay enough attention to the competition-neutrality of financial policies and to implement precise policies.

2 Theoretical analys and research hypothes

2.1 Financial policy competition neutrality and firms real cost of financing

From the perspective of the credit dimension, some studies have assumed that private enterprises are forced to bear higher financing costs, shorter financing terms and lower financing amounts, which makes it more difficult for private enterprises to face the risk of macroeconomic fluctuations(Qing et al.,2019). The unequal treatment encountered by private enterprises in the credit market can vary significantly with changes in the external macro environment. When the real economy is affected, fluctuations in collateral prices, capital adequacy regulations and other factors will cause changes in commercial banks' risk selection, resulting in commercial banks' credit behaviour being affected by macroeconomic fluctuations. From the perspective of business ownership, as the economy fluctuates, there will also be differences in the allocation of credit funds between businesses with different ownership structures. In addition, in the case of tightening monetary policy, the scale of bank lending is restricted, and banks will be more inclined towards

state-owned enterprises, a highly qualified object, when making lending decisions, resulting in more pronounced credit rationing during the time of tightening monetary policy. In the face of the raging new Crown Pneumonia epidemic, the problem of difficult and expensive financing may become the last straw in crushing private enterprises under the epidemic crisis. Maintaining a reasonable abundance of liquidity and increasing credit support for small and micro enterprises and private enterprises has become the focus of financial support for epidemic prevention and control. A series of financial policy arrangements are intended to solve the urgent problem of a tight capital chain for private enterprises and SMEs that are more affected by the epidemic and further promote the implementation of the principle of competitive neutrality. This paper argues that some of the previous non-competitively neutral conditions at the implementation level of the credit market can be effectively mitigated when the operating conditions of private enterprises are given focused attention, the importance of supporting private enterprises becomes particularly prominent, and the financial policies are tilted significantly in favour of private enterprises. Therefore, this paper proposes the hypothesis:

Hypothesis H1: Competitive neutrality of financial policy can significantly reduce the real cost of enterprise financing

2.2 Financial policy competition neutrality、internal control quality and firms real cost of financing

Based on the property rights perspective, non-state-owned enterprises are more likely to suffer from "credit discrimination" than state-owned enterprises, especially when the actual capital market is far from perfect; the ability of non-state-owned enterprises to raise external financing is more affected by factors such as information asymmetry, information risk, and agency problems, which leads to a greater degree of restriction on the scale of external financing for enterprises. In particular, when the transmission of monetary policy is primarily through the credit channel, those companies with significant information asymmetry problems will be impacted even more severely (Daniele and Andrea, 2014). Therefore, in China's financial market development is far from mature, the enterprise's external financing mainly comes from bank credit under the special institutional environment. Once the monetary policy tends to tighten, non-state-owned enterprises are more likely to suffer from the bank's "credit discrimination". Therefore, they have greater incentives to improve the quality of internal control in order to convey the signal of the enterprise's real quality to the bank and to alleviate the credit errors caused by information asymmetry. Therefore, they have more incentives to improve the quality of internal control in order to signal the real quality of enterprises to banks, alleviate the credit mismatch caused by information asymmetry, and reduce debt financing costs.

Research has shown that information asymmetry between banks and firms is the main cause of credit mismatches in credit markets. According to the general principles of credit, the security of loan funds and the avoidance of losses are of paramount importance. Since the bank cannot directly control the use and investment of credit funds after the loan is issued, and thus the recovery of the loan principal is at risk, the enterprise needs to release information to show its compliance in using the credit funds and the reliability of repaying the credit funds, and the bank needs to confirm that the enterprise's signals are sound. As an important part of internal control, a sound risk management system, including risk assessment and response procedures, as well as effective risk control activities and standardized authorisation, approval and other control activities, can also effectively control and reduce business risks. This can improve the credibility of information disclosure and reduce the bank's evaluation of enterprise risks, thus avoiding low credit rationing behaviour due to

asymmetrical information. To summarise the analysis, the quality of internal control is an intermediary bridge connecting the competitive neutrality of financial policy and the actual cost of financing. Therefore, the hypothesis of this paper is proposed:

Hypothesis H2: Internal control quality positively strengthens the inhibitory effect of financial policy competitive neutrality on the real financing cost of enterprises

3 Research design

3.1 Sample and data sources

This paper selects all listed companies in Shenzhen and Shanghai from 2011 to 2022 as the initial sample, and excludes the following company samples: (1) excludes financial industry samples (2) excludes the samples with missing financial data; (3) excludes the samples with missing actual controllers and places of incorporation; and (4) excludes the companies that issue B or H shares at the same time, as the companies that issue B or H shares at the same time face the regulations of dual regulation, their internal control construction is different from the general listed companies in China. In order to exclude the influence of extreme values, we exclude them according to the three times standard deviation criterion. Meanwhile, to ensure the reliability of the research findings, we also Winsorise the continuous variables by the 1% and 99% standards for robustness, and the results are basically the same.

3.2 Definition of variables

Actual Financing Cost (AFC), this paper adopts the weighted average interest rate of general loans and the comprehensive lending rate of one-year financing to measure the financing cost faced by enterprises in the bank credit market and private lending market, respectively. At the same time, because the real interest rate is the real cost of funds faced by enterprises when making investment and financing decisions, this paper mainly focuses on the impact of monetary policy on the real interest rate in the bank credit market and private lending market. Theoretically, according to the Fisher equation, the real interest rate is equal to the nominal interest rate minus the expected inflation rate. However, in reality, there is no consistent conclusion on the measurement of expected inflation in China. Currently, the more official indicator to reflect the expected inflation change is the future price expectation index published by the central bank, but the measurement of this index still has two shortcomings for the research of this paper. First, the index is based on the central bank's questionnaire survey of depositors on price level changes in the next quarter. The number of residents who chose "can't be seen" was first deducted. Afterwards, the proportion of residents who believe that prices in the next quarter will "rise" or remain "basically unchanged" is calculated, along with the proportion of residents who believe that prices in the next quarter will "fall" or remain "basically unchanged". The proportion of residents who think prices will "increase" and "basically unchanged" in the next quarter are then calculated separately, and then summed up after assigning weights of 1 and 0.5 respectively. It only includes residents' expectations of price increases and no change and does not better reflect residents' expectations of price declines. Secondly, the index is actually a weighting of the number of residents who hold different views on price changes, and does not reflect the specific price levels expected by these residents. Therefore, numerous studies have been conducted to measure the real interest rate using the ex post interest rate algorithm, which subtracts the nominal interest rate from the inflation rate over the same period of time. In view of this, this paper chooses the year-on-year growth rate of the Producer Price Index (PPI) as a measure of inflation, and subtracts the PPI from the nominal financing rate of the two financing markets to obtain the corresponding real financing rate as an alternative measure of the real financing cost.

Financial Policy Competitive Neutrality (FPCN), this paper uses supply chain support to measure financial policy competitive neutrality. According to the research literature on commercial credit, supply chain support is defined as the commercial credit support provided by core enterprises for upstream and downstream enterprises. The ratio of the total of accounts receivable, notes receivable and prepayments to the total assets is utilized to signify the commercial credit assistance given by debt-issuing companies to upstream and downstream companies in the supply chain. The larger this ratio is, the more commercial credit is granted to upstream and downstream firms by the debt issuing firm, reflecting the commercial credit support of the debt issuing firm to the whole supply chain, and the higher the degree of competitive neutrality of the financial policy.

Internal control quality (ICQ), this paper adopts the internal control index of Chinese listed companies compiled by the Internal Control Index Group of Xiamen University. The index is based on the principles of internal control evaluation system design, combined with the basic situation of internal control of listed companies in China. The Basic Standard for Enterprise Internal Control and its supporting guidelines are used as the main basis for index design. Other laws and regulations are taken into account, and existing domestic and international internal control evaluation methodology is drawn upon. First-level evaluation indexes are set for the internal environment, risk assessment, control activities, information and communication, internal supervision and others. Finally, the internal control index is formed based on the weighted average method. The index uses a percentage system whereby the maximum possible score is 100 points and the lowest score is 0 points. The greater the score, the stronger the internal control.

(3) Variables that are under control. Referring to other factors that may affect the actual cost of financing, this paper selects eight variables such as company size (SIZE), enterprise age (AGE), gearing ratio (LEV), return on equity (ROE), consolidated tax rate (TAX), cash ratio (CASH), agency cost (AGENCY), and board of directors' size (BS), etc., and gives them control.

3.3 Model setting

In order to study the effect of financial policy's competitive neutrality on the real financing cost of enterprises, a model is constructed based on the research hypothesis, as shown in equation (1). In addition, to study the mediating effect of internal control quality, the regression model of financial policy competitive neutrality (FPCN) and internal control quality (ICQ) is constructed as shown in Equation (2), as well as the regression model of internal control quality (ICQ), financial policy competitive neutrality (FPCN), and actual financing cost (AFC) as shown in Equation (3). Actual financing cost may be affected by industry and time, so a time dummy variable (Year) and an industry dummy variable (Ind) are needed to control for time and industry.

$$AFC_{i,t} = \alpha_0 + \alpha_1 FPCN_{i,t} + \sum Controls + \lambda_1 \sum Year + \lambda_2 \sum Ind + \varepsilon_{i,t} \quad (1)$$

$$ICQ_{i,t} = \alpha_0 + \alpha_1 FPCN_{i,t} + \sum Controls + \lambda_1 \sum Year + \lambda_2 \sum Ind + \varepsilon_{i,t} \quad (2)$$

$$AFC_{i,t} = \alpha_0 + \alpha_1 FPCN_{i,t} + \alpha_2 ICQ_{i,t} + \sum Controls + \lambda_1 \sum Year + \lambda_2 \sum Ind + \varepsilon_{i,t} \quad (3)$$

4 Empirical results and analys

4.1 Descriptive statatical analys

Table 1 gives the descriptive statistics of the main variables. The mean value of actual financing cost (AFC) is 0.54, the maximum value is 0.97, the minimum value is 0.13, and the standard deviation is 0.59, which indicates that the predicament of actual financing difficulties of firms in the sample area is widespread, and that there is a significant difference in their costs among firms in different areas.The mean value of FPCN is 0.51, and the rest of the control variables take values that are within the normal range, and will not be discussed further.

Table 1: Descriptive statatics of the main variables

Variable	sample capacity	mean	standard error	least value	crest value
AFC	10024	0.54	0.59	0.13	0.97
FPCN	10024	0.51	0.41	0.11	0.92
ICQ	10024	0.48	0.33	0.12	0.91
LEV	10024	0.11	0.04	0.01	0.32
ROE	10024	0.21	0.09	0.08	0.37
TAX	10024	0.15	0.07	0.05	0.36
SIZE	10024	0.17	0.11	0.03	0.42
AGENCY	10024	0.22	0.13	0.05	0.55
CASH	10024	0.31	0.11	0.09	0.66
AGE	10024	0.11	0.10	0.03	0.31
BS	10024	0.17	0.11	0.02	0.36

4.2 Benchmark regression

In column (1) of Table 2, the regression coefficient of FPCN is -0.762 and significantly negative at 1% level, and the result supports hypothesis H1. indicating that the competitive neutrality of financial policies reduces the real cost of financing for firms. In addition, in column (2), the regression coefficient of FPCN × ICQ is -0.818 < -0.762 and significant at 1% level, which supports hypothesis H2. It indicates that the quality of internal control significantly and positively strengthens the inhibitory effect of competitive neutrality of financial policy on the real cost of financing.

Table 2. Benchmark regression results

Variable	(1)	(2)
	AFC	AFC
FPCN	-0.762*** (-1.349)	-0.311*** (-1.671)
FPCN×ICQ		-0.818*** (-2.642)
LEV	3.118*** (2.263)	3.332*** (2.836)
ROE	-0.135 (-0.276)	-0.364 (0.441)
TAX	0.251*** (3.127)	0.358*** (3.736)
SIZE	4.356*** (3.353)	4.331*** (2.351)
AGENCY	0.178*** (4.154)	0.735*** (4.169)
CASH	0.144*** (2.182)	0.115*** (2.196)
AGE	0.129** (2.137)	0.191*** (2.334)
BS	6.338*** (4.315)	5.279*** (3.125)
-Cons	-8.351*** (-7.778)	-9.166*** (-8.713)
N	10024	10024
R^2	0.125	0.128
R^2-a	0.119	0.121

Note: * * *, * * and * indicate significant correlation at 1%, 5% and 10% levels, respectively, with t values in parentheses

4.3 Mediation effect test

Regressions were conducted according to equation (2) and equation (3) of the model, and the results are shown in Table 3. The first column of the results regresses the effect of financial policy competitive neutrality on internal control quality (ICQ), and its regression coefficients are all

significantly positive at the 1% confidence level, indicating that financial policy competitive neutrality has a significant positive effect on internal control quality.

The second column of the result is the regression of the effect of internal control quality (ICQ) on actual financing cost (AFC), and the regression coefficients are all significantly negative at 1% confidence level, indicating that the greater the quality of internal control, the more conducive to reducing the actual financing cost. According to the formula of "mediation effect = coefficient of independent variable on mediator variable × coefficient of mediator variable on dependent variable", the mediation effect of the variable of "financial policy neutrality" on the actual financing cost through the quality of internal control is -0.797, and the ratio of the direct effect of financial policy neutrality on the actual financing cost is 0.922, which are all within 1% confidence level. 0.922, which are all significant at 1% confidence level. In other words, the inhibitory effect of the variable "competitive financial policy" on the actual financing cost accounts for 92.2%; 92.2% of the inhibitory effect of the variable "competitive financial policy" on the actual financing cost is mediated by the quality of internal control. The hypothesis H2 is tested. The research hypothesis H2 is tested.

Table 3 Intermediation effect test results

Variable	ICQ	AFC
FPCN	0.892*** (1.771)	-0.394*** (-0.027)
ICQ		-0.894*** (-1.552)
LEV	4.148*** (4.276)	4.017*** (4.002)
ROE	0.281 (0.356)	0.144 (0.125)
TAX	0.361*** (5.834)	0.239*** (3.557)
SIZE	4.129*** (3.155)	4.339*** (1.256)
AGENCY	0.531*** (4.991)	0.618*** (4.365)
CASH	0.151*** (2.121)	0.298*** (5.281)
AGE	0.927** (2.008)	0.222*** (2.195)
BS	5.771*** (4.446)	7.827*** (4.112)
Year	Control	Control
Ind	Control	Control
-Cons	8.173*** (7.813)	-9.922*** (-8.155)
N	10024	10024
R^2	0.837	0.922
R^2-a	0.418	0.517

Note: * * *, * * and * indicate significant correlation at 1%, 5% and 10% levels, respectively, with t values in parentheses

4.4 Robustness test

4.4.1 Instrumental variable testing based on explanatory variables

Based on the literature, this study uses the amount of cooperation between listed companies and financial institutions (Qua) as a proxy variable for the competitive neutrality of financial policies, as shown in Table 4. The first column of the model is the correlation between (Qua) and the original explanatory variable (FPCN). The coefficient results are all significantly positive at the 1% confidence level, indicating a significant correlation between the number of instrumental

variables (Qua) and the explanatory variable (FPCN). The second column of the model is a regression of the effect of the number of instrumental variables (Qua) on the actual financing cost (AFC). The result of this coefficient is significantly negative at 1% confidence level which is consistent with the above results.

Based on previous literature, it is known that factors such as the level of economic development of the region and the intensity of competition in the industry affect the competitive neutrality of financial policies. Therefore, this study further uses the level of economic development (FPCN-Economic) and the intensity of competition in the industry (FPCN-Industry) in which the region is involved in financial competition as indicators of financial policy competitive neutrality. The results are shown in the third and fourth columns of the model in Table 4 and the results for both variables pass the significance test. It shows that the intensity of competition in the industry can significantly affect the real cost of financing with the help of competitive neutrality of financial policy. This result is consistent with the above regression results, indicating that the above findings are robust.

Table 4 Results of instrumental variables test based on explanatory variables

Variable	FPCN	AFC	AFC	AFC
Qua	0.882*** (1.134)	-0.877*** (-1.131)		
FPCN-Economic			-0.879*** (-1.133)	
FPCN-Industry				-0.876*** (-1.129)
Controls	Yes	Yes	Yes	Yes
Year	Control	Control	Control	Control
Ind	Control	Control	Control	Control
-Cons	1.114*** (2.871)	-1.117*** (-2.882)	-1.119*** (-2.885)	-1.118*** (-2.883)
N	10024	10024	10024	10024
R^2	0.133	0.135	0.136	0.135
R^2-a	0.079	0.081	0.084	0.082

Note: * * *, * * and * indicate significant correlation at 1%, 5% and 10% levels, respectively, with t values in parentheses

4.4.2 Instrumental variable testing based on explained variables

Combined with numerous studies by previous scholars, this paper selects the annual financing amount (Amount) and the number of annual financing contract signing contracts (Number) of the actual financing cost as the explanatory variables to be regressed. The regression results are shown in Table 5. The regression coefficients of Financial Policy Competitive Neutrality (FPCN) are -0.887 and -0.891 respectively under the effect of annual financing amount and annual number of financing contracted contracts, and the regression coefficients are significantly negative at 1% confidence level, which is consistent with the results of the above studies, indicating that the results of the above studies are robust.

Table 5 Results of instrumental variables test based on explanatory variables

Variable	AFC	
	Amount	Number
FPCN	-0.792*** (-1.812)	-0.794*** (-1.854)
Controls	Yes	Yes
Year	Control	Control
Ind	Control	Control

-Cons	-3.324*** (-2.417)	-3.357*** (-2.491)
N	10024	10024
R^2	0.309	0.311
R^2-a	0.183	0.184

Note: * * *, * * and * indicate significant correlation at 1%, 5% and 10% levels, respectively, with t values in parentheses

5 Main research conclusions and policy suggestions

5.1 Main findings

Exploring the breakthrough path to reduce the real financing cost from the perspective of competitive neutrality of financial policies, analysing its functioning mechanism, and enriching the existing research on financing cost. At the same time, based on the perspective of internal control quality, we introduce the "quality of internal control", and build up a triple framework of "financial policy competition neutrality - quality of internal control - actual financing cost", expanding the basic theoretical framework of "financial competition → financing dilemma" and "financial competition → financing dilemma". It expands the theoretical content and research boundaries of "financial competition-financing dilemma" and integrates internal and external factors.

(2) Provide theoretical basis and practical guidance for national government departments to pay sufficient attention to financial policy neutrality and implement precise policies.

5.2 Policy suggestions

For the government, it should reasonably deal with the correlation between the competitive neutrality of financial policies and the actual financing costs, so as to realize functional complementarity and bring into play the effect of the "system as a whole", and guide enterprises to actively take measures to seek a breakthrough path for financing difficulties by continuously improving the quality of internal control. At the same time, appropriate open and transparent disclosure of information subject to the supervision of financial institutions broadens their information channels. This allows multi-angle access, refinement and interpretation of signals, thus helping to prevent the destructive effects of vicious financial policy competition on actual enterprise financing.

For enterprises, it is important to fully realise that the quality of internal control plays a significant role in reducing financing costs. The higher the quality of internal control, the more one can maximise the activation of the positive effect of enterprise financial innovation, in order to effectively avoid the financial crisis brought about by the risk effect and transfer of information, to better cross the geographical boundaries, and effectively overcome the financing difficulties of the predicament.

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Declaration of interests

☒ The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

☐The authors declare the following financial interests/personal relationships which may be considered as potential competing interests: