Governance Role of Different Types of State-Share Holders: Evidence from China’s Listed Companies

by WANG Jiwei

Department of Accounting
The Hong Kong University of Science and Technology

Abstract

This thesis extends the literature on the role of state ownership by distinguishing the governance roles of two types of state-share holders in China’s listed companies. Government agencies that act as state-share holders ("GA shareholders") are detrimental to firm value according to both the political and managerial perspectives. Non-government agencies such as SOEs and other forms of market-oriented economic entities acting as state-share holders ("corporate state-share holders") may not be detrimental to firm value because their goals are different from those of GA shareholders. The empirical findings are consistent with the predictions. Firms with GA shareholders perform significantly worse than other types of firms. Additionally, top management turnover is less sensitive to poor firm performance in firms with GA shareholders than in other types of firms. In contrast, there is no significant difference in performance between firms with corporate state-share holders and firms without state-owned shares. Moreover, the top management turnover in firms with corporate state-share holders is not more sensitive to poor firm performance than it is in firms without state-owned shares. The results suggest that it is the incentive of state-share holders, rather than state ownership per se, that is crucial in corporate governance for transitional economies.
CHAPTER 1
INTRODUCTION

The transitional process of a socialist economy to a market economy has become an important issue recently. Djankov et al. (2003) point out that “the interest in institutions revived with the collapse of socialism, and the transition of the economies in Eastern Europe, the former Soviet Union, and China to capitalism.” However, the transition experience has been diverse (see Djankov and Murrell (2002) for a review). Nellis (1999) states that the effectiveness of privatization in transitional economies depends on the existence of the institutional underpinnings of capitalism, such as legal and financial systems. In addition, empirical studies confirm the close relationship between good institutions and economic development (see, e.g., De Long and Shleifer (1993), Besley (1995), Knack and Keefer (1995), Easterly and Levine (1997, 2003), and Acemoglu, Johnson, and Robinson (2001)). On the other hand, Stiglitz (1999) suggests that using “better management contracts” to make state-share holders act like private owners is a better choice in the absence of those institutional underpinnings, a path which has been followed by the Chinese government in the past two decades. As noted in World Bank (1997), “most other countries in transition have turned to systemic, widespread privatization of state-owned enterprises (SOEs). In China, the state, or its agents, carry out ‘shareholder’ functions performed by private owners in market economic systems.” Retaining a large portion of state-owned shares in listed companies, the Chinese government delegates different types of state-share holders to control these state-owned shares.

1 A study of corporate governance conducted in 2002 by the China Securities Regulatory Committee (CSRC) and the State Economic and Trade Commission (SETC), on the basis of self-reporting alone, found that of 1,015 controlling shareholders in the 1,175 listed companies studied, 77% could be considered state organs. The study is reported in an interview minute with SETC Vice Chairman in Qi (2003).
This thesis attempts to examine the governance role of different types of state-share holders in China’s listed companies.

China’s transition from a central-planned economy to a market-oriented one is special and unique. Chinese government creates its own path of transition rather than just using a “blueprint” or “recipe” from western advisors. Chinese government has been always attempting to privatize its state-owned assets gradually rather than a “big bang” like that undertaken by Russia and some other former Soviet Union countries. To prevent potential social unrest from radical privatization, Chinese government retains a large portion (more than 30%) of state-owned shares in listed SOEs. Thus, the number of privately-listed companies not owned by Chinese government are relatively few in China. In this business environment, it will be more interesting to investigate the role of different types of state-share holders in corporate governance than to compare the role of state-share holders with that of private shareholders. I expect that different types of state-share holders may have different incentives and thus execute different governance roles in listed companies.

Based on the degree of political interference, state-share holders in China’s listed companies can be classified into two groups: one is “government agency state-share holders” (GA shareholders, hereafter), which are government agencies (or institutions constructed from former government agencies) including central government ministries and commissions, national industry groups, local government bureaus, local state assets management bureaus, and local state assets management companies. The other is “corporate state-share holders”, which are non-government agencies such as SOEs or other types of market-oriented economic entities. These two types of state-share holders differ in the degree of governmental interference, which has been blamed as one reason for the inefficiency of state-owned assets. GA
shareholders are expected to be detrimental to firm performance because they are purely government agencies and exercise a high degree of government intervention. On the other hand, corporate state-share holders have less government intervention because they have much more autonomy (World Bank (1997), Broadman (2001)). Thus, corporate state-share holders act more like private owners than GA shareholders and are likely to play a more effective role in corporate governance.

The thesis explores two aspects of the governance roles of different types of state-share holders. One is the relationship between firm performance and ownership percentage held by different types of state-share holders. The other is the effect of different types of state-share holders on the sensitivity of top management turnover to poor firm performance. For comparison, the study also includes the listed companies without any state-owned shares. I predict that firms with GA shareholders will under-perform firms with corporate state-share holders and firms without state-owned shares. In addition, GA shareholders will weaken the sensitivity of top management turnover to poor firm performance. The empirical findings are consistent with the predictions. The performance of firms with GA shareholders is significantly lower than that of firms with corporate state-share holders or firms without any state-owned shares. In addition, top management (both CEO and chairperson of the board of directors) turnover is less sensitive to poor firm performance in firms with GA shareholders than in other types of firms. On the other hand, there is no significant difference in performance between firms with corporate state-share holders and firms without state-owned shares. Moreover, the top management turnover in firms with corporate state-share holders is not more sensitive to poor firm performance than in firms without state-owned shares.
This thesis contributes to the literature on transitional economies by distinguishing the governance roles of different types of state-share holders under China’s gradual privatization process. Previous studies on other transitional economies focus on the role of different types of private owners such as managers, foreign owners, and investment funds (Djankov and Murrell (2002)). In addition, studies on China’s listed companies, such as Xu and Wang (1999), Firth, Fung, and Rui (2002), and Sun and Tong (2003), do not differentiate different types of state-share holders. This thesis is new in that it demonstrates the effect of different types of state-share holders on firm performance and CEO turnover. My findings suggest that firm performance and the effectiveness of monitoring mechanism do not depend on who owns shares (e.g., state or private) but depends on the incentive structure of different state-share holders. This result supports the suggestion by Stiglitz (1999) that the introduction of market-oriented state-share holders (such as the corporate state-share holders highlighted in the thesis) is a desirable transitional process before the ownership of state is transferred to private entities. In addition, the result of this thesis has implications for China’s future sale of state-owned shares in listed companies. Chinese government could increase the efficiency of economy by selling the state-owned shares held by government agencies (GAs, hereafter) to the public or delegate the control rights attached to these shares to market-oriented economic entities.

The remainder of this thesis is organized as follows. Chapter 2 reviews previous literature on the inefficient role of state ownership of shares, the relationship between ownership structure and China’s listed firms’ performance, and top management turnover in China’s listed companies. Chapter 3 introduces China’s institutional background and my classification of state-share holders in China’s listed
companies. Chapter 4 develops the hypotheses. Chapter 5 describes the methodology used to test the relationship between the type of state-share holders and firm performance and presents the empirical results. Chapter 6 provides the empirical tests and results on the effect of the type of state-share holders on the sensitivity of top management to poor firm performance. The final chapter concludes the thesis.