CHAPTER 7

CONCLUSION

China is undergoing a process of transition from being a centrally planned economy to a market economy and this provides us a unique opportunity to examine the role of state shareholdings in transitional economies. Some economists have examined the effect of state shareholdings on the performance of China’s listed companies (see, e.g., Xu and Wang (1999), Tian (2001), and Sun and Tong (2003)). All the previous studies use the percentage of state-owned shares to proxy for the role of government shareholding but fail to find consistent results. Through a finer classification of the identity of state-share holders, this study shows that the performance of China’s listed companies is not determined by the state ownership per se. Rather, the types of state-share holders are more important determinants.

Specially, this study classifies state-share holders into two groups based on the degree of government intervention: GA shareholders and corporate state-share holders. GA shareholders are purely government agencies and thus they are the best proxy for government shareholdings which are claimed by both political and managerial views to be detrimental to firm performance. Corporate state-share holders have different objectives from those of GA shareholders because they are more market-oriented. In addition, corporate state-share holders have much more autonomy and thus bear less degree of government intervention. Moreover, Chinese government has been introducing better management incentive contracts to corporate state-share holders. Thus, corporate state-share holders could play a more efficient governance role than GA shareholders, although both of them hold state-owned shares.
Two measures are employed in this study to distinguish governance roles of different types of state-share holders. One is the relationship between firm performance and the type of state-share holders. The other is the monitoring function of different types of state-share holders on top management which is measured by the sensitivity of management turnover to poor firm performance. The empirical results are consistent with the predictions. Listed firms with GA shareholders significantly underperform other types of firms including firms with corporate state-share holders. The performance, measured as accounting rates of return, is a negative function of the percentage of state-owned shares held by GAs rather than the percentage of state-owned shares, even after controlling for endogeneity of ownership. In addition, the top management turnover in listed firms with GA shareholders is less sensitive to poor firm performance than that in other types of firms. Finally, 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 could also lend support to the view that the identity of a blockholder is crucial in corporate governance (see, among the others, Barclay and Holderness (1991), Brickley, Lease, and Smith (1988), and Leleux, Vermaelen, and Banerjee (1997)).

The results have implications for transitional economies. With the absence of institutional underpinnings of capitalism, mass privatization has been proved to be an inefficient transition strategy. Delaying privatization and introducing market-oriented state-share holders, just like corporate state-share holders in China, may be a better formula for transition. Qian (2002) also observes that some “transitional institutions” (such as the corporate state-share holders highlighted in this study) are the key drivers for China’s successful transitional progress.
The results also have implications for China’s future sale of state-owned shares in listed companies. On June 12 of 2001, the State Council of People’s Republic of China issued a proposal to sell portion (10%) of the state-owned shares in listed companies (Asian Wall Street Journal (2001)). Four months later, on October 23, Chinese government suspended the proposed sell-off of state-owned shares. The primary concern of the government is the valuation of the state-owned shares which could affect minority shareholders’ interests. The results in this study suggests that different governance roles of different types of state-share holders be another important consideration for Chinese government’s future sell-off decision: the state-owned shares held by GAs should be released first. Chinese government could either sell this portion of state-owned shares to the public or delegate some market-oriented entities (corporate state-share holders) to control them.

The interpretation of the results in this study is subject to four limitations. First, the classification of state-share holders based on their names is not good enough to distinguish GA shareholders and corporate state-share holders perfectly. For example, most state assets operating companies use the name of “State Assets Operating Company”, such as “Jiangshu State Assets Operating Company”. But some operating companies, which should be classified as GA shareholders, could use other names and then are classified as corporate state-share holders in this study. Second, corporate state-share holders could have more incentives and means to manage earnings to improve performance through related-party transactions than GA shareholders because they are holding companies (Jian (2003)). In this study, the potential earnings management through non-operating activities found in Chen and Yuan (2002), such as sales of fixed assets, has been controlled but the earnings

44 See a report from People’s Daily, a leading newspaper in China. The report is available online at http://fpeng.peopledaily.com.cn/200202/01/eng20020201_89740.shtml.
management through related-party transactions cannot be controlled. Third, the incentive difference between GA shareholders and corporate state-share holders need to be explored more extensively. It would be more convinced if we could show different performance-driven compensation structure for the two types of state-share holders. Finally, due to lack of data availability, some factors found in the existing studies (such as managerial ownership and board composition) which can determine the likelihood of management turnover cannot be included as independent variables in this study.

This study also suggests several avenues for future research. While the benefit of corporate state-share holders has been documented in this study, the cost of them (such as insider control problems) cannot be ignored and remains an open question. More theoretical work is needed to understand the benefit and cost of different types of state-share holders. Another potential area of research is to investigate their incentives to manage earnings for different types of state-share holders.