Performance of Chinese Listed Companies

With Respect to Ownership Structure, Concentration and CEO Characteristics

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Synopsis

In this dissertation, I aim to examine the performance of Chinese listed companies with respect to ownership structure, ownership concentration and CEO characteristics. This research study differs from previous studies in two major aspects. Firstly, it is not entirely based on the agency theory. For example, the socialized approach assumes that there is a positive relationship between state ownership and agency cost (Chizema and Le, 2011). Therefore, a negative relationship exists between the performance of a firm and its ownership by the state (Saunders and Travlos, 1990). In contrast, it can be argued that state ownership has a positive impact on the performance of a firm (Chizema and Le, 2011). As privatization in China is not in the strict institutional context, the state may still interfere with the firm in a subjective manner (Bachiller, 2009). Secondly, it explains the relationship between the performance of a firm (accounting returns) and the value of a firm (return based on market), proposing an effect that moderates the state ownership. It is argued that state ownership has a positive effect on the performance of a firm, and a negative effect on the market value of a firm.

Ownership concentration is also found to have an impact on a firm’s performance. In the context of China the background of the ownership may also have an impact on firm performance. Concentration of ownership in the hands of the state may have a different effect on firm performance than ownership concentration by institutions or private individuals.

As the Chinese economy continues to develop and transition from a centrally planned one to a market based one, corporatization also goes along. Government
interference on day to day management of government companies gradually subsides. The reliance on professional management also increases with the power of the CEO getting stronger. This research study aims to study the effect of CEO characteristics on firm performance as it relates to China. The impact of CEO characteristics is worth further study as the focus of corporate governance at Chinese listed firms gradually evolves from being dictated by ownership structure and concentration to more involvement of the CEO.

This research study aims to answer the following research questions.

1. Is the ownership structure significantly associated with the performance of Chinese listed companies?

2. Is the ownership concentration significantly associated with the performance of Chinese listed companies?

3. Are the CEO characteristics significantly associated with performance of Chinese listed companies?

Regression analysis has been used to test the hypotheses that are established based on these research questions. Research data adopted are based on all listed firms on the Shanghai and Shenzhen Exchanges that have issued “A” shares and been consistently trading for the period from 2010 to 2012.

Quantitative analysis returns a conclusion that there exists a positive impact on the performance of a firm government with respect to its ownership structure, ownership concentration as well as CEO characteristics. It is anticipated that going forward the
role of the CEO in Chinese companies will become more significant although most Chinese listed companies, both state and privately owned companies alike, still have a controlling shareholder. How the CEOs of Chinese listed companies discharge their duties in a heavy ownership concentration situation where the controlling shareholders are still actively involved in company operations and decisions will be an interesting topic for further study.
Table of Contents

List of Tables

LIST OF TABLES .......................................................................................................................... 8
ABBREVIATIONS .......................................................................................................................... 9

CHAPTER 1: INTRODUCTION ........................................................................................................ 10
1.1 BACKGROUND OF THE STUDY .......................................................................................... 10
1.2 CONTEXT AND GOVERNANCE STRUCTURES ................................................................. 14
1.3 GOVERNANCE AND SEPARATION OF OWNERSHIP AND CONTROL ......................... 15
1.4 REFORM OF STATE OWNED ENTERPRISES AND OWNERSHIP STRUCTURE IN CHINA .... 16
1.5 INSTITUTIONAL BACKGROUND ....................................................................................... 17
1.6 CLASSIFICATION OF SHAREHOLDERS IN CHINA .......................................................... 19
1.6.1 Share Ownership ........................................................................................................... 19
1.6.2 Tradable A, B-shares, and other shares ......................................................................... 20
1.7 DEVELOPMENT OF THE CHINESE STOCK MARKETS .................................................. 21
1.8 OWNERSHIP STRUCTURE OF LISTED CHINESE COMPANIES ........................................ 22
1.9 OWNERSHIP STRUCTURE AND CORPORATE PERFORMANCE ................................. 23
1.11 RESEARCH OBJECTIVES AND QUESTIONS .................................................................... 25
1.12 CORRELATION BETWEEN PERFORMANCE AND OWNERSHIP STRUCTURE ............... 28
1.13 SPECIFIC ENVIRONMENTAL CONTEXT ........................................................................... 30
1.14 RESEARCH PARADIGM ..................................................................................................... 30

CHAPTER 2: LITERATURE REVIEW ............................................................................................. 33
2.1 MACRO LEVEL STUDIES ...................................................................................................... 33
2.1.1 A Multitask Theory of State Enterprise Reform .......................................................... 33
2.1.3 Agency Theory ............................................................................................................. 35
2.1.4 The Industrial Organization theory .............................................................................. 36
List of Tables

Table 2.1 Turnover Statistics of the Shanghai Stock Exchange
Table 2.2 Count of Listed Companies on the Shanghai Stock Exchange
Table 2.3 Turnover Statistics of the Shenzhen Stock Exchange
Table 2.4 Count of Listed Companies on the Shenzhen Stock Exchange
Table 2.5 Turnover Summary of the Shanghai and Shenzhen Stock Exchanges
Table 2.6 Sector Distribution and Number of Listed Companies on the Shanghai and Shenzhen Stock Exchanges
Table 4.1 Relationship among foreign ownership, institutional ownership, private ownership, managerial ownership, state ownership and ROE
Table 4.2 Basic statistics for categorized concentration measures across all firms
Table 4.3 Coefficients for L1, L2, L3, K2 and K3
Table 4.4 Correlation between CEO characteristics and ROE
**Abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>SOE</td>
<td>State-Owned Enterprises</td>
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<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>CFO</td>
<td>Chief Financial Officer</td>
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<tr>
<td>AROA</td>
<td>Adjusted Return on Assets</td>
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<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GVIO</td>
<td>Gross Value of Industrial Output</td>
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<td>IPO</td>
<td>Initial Public Offering</td>
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<td>MNC</td>
<td>Multi-national Corporations</td>
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<tr>
<td>ROA</td>
<td>Return on Assets</td>
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<td>ROE</td>
<td>Return on Equity</td>
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<td>SCRES</td>
<td>State Commission for Restructuring the Economic System</td>
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<td>SEZ</td>
<td>Shenzhen Special Economic Zone</td>
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<td>SHX</td>
<td>Shenzhen Stock Exchange</td>
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<td>SZX</td>
<td>Shanghai Stock Exchange</td>
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<td>TFP</td>
<td>Total-factor Productivity</td>
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<td>TVE</td>
<td>Township-Village Enterprises</td>
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Chapter 1: INTRODUCTION

This chapter gives a snapshot of the structure of this dissertation. It outlines the flow of the research study and the conclusion reached from the quantitative testing results. It starts with a description of the background against which the research topic was chosen. The issues pertaining to the research topic are then identified, followed by a depiction of the quantitative approach used in the research study. Finally, the conclusion provides an interpretation and articulation of the research results.

1.1 Background of the Study

China had adopted a central planning economic model in the three decades since 1949. The result was widespread inefficiency and low productivity among enterprises which were all owned by the state. In 1978, China started to introduce market reforms, beginning with the establishment of four Special Economic Zones (SEZs) in order to attract foreign capital. These SEZs are respectively located in Shenzhen, Xiamen, Zhuhai and Shandon, all seaside cities in the coastal provinces of Guangdong and Fujian.

China’s reform in the economic sector since 1978 had resulted in profound and rapid transformations in the countryside. This has resulted in rapid expansion in TVEs (Township-Village Enterprises); thus greatly transforming the rural area. According to Wu (1994), the constant increased growth rate of China did not result from the urban economy that had industries that were owned by the state; but rather the rural one dominated by the agricultural sector. Guldin (2001) opines that the growth exhibited
among the TVEs has absorbed the excess labor in the agricultural sector as a result of the dismantlement of communes. Consequently, the labor force was expanded at the rate of 13% per annum during the 1980s. As a result, 135 million individuals had been employed by 1997. The expansion of China’s industrial production has been escalated by the TVEs thus contributing 26%, 44%, and 35% to the Gross Domestic Product (GDP), Gross Value of Industrial Output (GVIO) and export earnings respectively and attaining a 15% increase in production per annum in the mid-1990s (Nabeshima et al., 2006; Allen et al., 2005).

SOEs (State Owned Enterprises) used to be China’s foundation of economy in the past. However, their level of productivity has declined since the economic reform in 1978. Many factors have contributed to the SOE’s relative inefficiency, but the major one is that the SOEs are still not strictly operated under commercial principles. Due to the widespread inefficiency among SOEs, reforms had to be carried out to improve the situation. The reform was essential as the number of enterprises in the private and foreign-funded sectors continued to grow. These enterprises in general performed much better than the SOEs and quickly became a significant constituent of the economy in the past twenty years. While they were initially allowed only on the fringes of the economy, they grew to account for about a third of gross domestic product and were officially recognized as an important component of the economy. Since 1978, China has adopted a diverse business system that is made up of different ownership categories, including SOEs and PEs.

The market shares and contributions to GDP by firms in each of the corporate categories have changed as a result of the transformation of the economic model from one that was centrally planned to one that was driven by the market since 1978 (Yueh, 2012). The economy of the country has since become more market-oriented. The ever-
expanding private enterprise sector adapts to the market much faster as they operate under commercial principles. Therefore, it is easy to understand why the level of productivity of private enterprises has been following an upward trend since 1978 (Allen et al, 2006).

It is of vital significance to understand the importance of this type of ownership since the firms in this category are the closest competitors of the SOEs in China. Those better performing privately-owned enterprises, while being considered staunch competitors and a threat to the state-owned enterprises, also become one of their role models. There is a trend for developing countries to transform their economies to systems that are market based, while at the same time privatizing firms in the public sectors. As a result, a number of ownership structures have emerged in the firms that are privatized (Sun and Wilson, 2003, Bachiller, 2009). In an attempt to understand the impact that privatization has had on a firm’s ownership structure, Bhabra (2007) and Sun and Tong (2003) have used the agency theory for studying the correlation between a firm’s performance and its ownership. They have also studied the relationship between the performance of a firm and its value (Boardman et al., 2002, Jensen and Ruback, 1983; Delios et al., 2006).

The results obtained from the researches are mixed and at times inconclusive. Some of the scholars suggest that there are other issues, for example, competition or legal environment, which should be part of the variables for determining the relationship between performance and ownership especially with regard to privatization (Delios et al, 2001). The development path of China is unique and is different from the development paths of the Eastern European nations (Megginson and Randenborgh, 1994). China has transformed itself without making changes to its political system. The situation can possibly explain the reason why a high proportion of the firms are still
dominantly owned by the Chinese government (Bachiller, 2009). For purposes of studying the relationship between the ownership structure and the performance of the listed companies in China, listed companies in China can be classified into Sino-foreign joint ventures, majority government owned enterprises and private firms.

Not all shares issued by a company are freely transferable in the open market. Some may only be transferred to institutions in blocks. For example, there are the so-called "legal person shares" which are not tradable on the open market but are transferrable to other institutions. The existence of this class of shares does provide more liquidity to the market (Banker and Charnes, 1984). Although most of these non-tradable shares are under the control of the Chinese government, the presence of these institutional shares may result in a positive transformation of the firm’s performance (Stiglitz, 2001). The dissertation aims to examine the performance of Chinese listed companies with respect to ownership structure, ownership concentration and CEO characteristics. Agency theory forms the backbone of this research but other references have been considered as well. For example, the socialized approach assumes that there is a direct relationship between agency cost and state ownership. Therefore, an indirect relationship possibly exists between the performance of a firm and its ownership by the state (Saunders and Travlos, 1990). In contrast, it can be argued that state ownership positively affects the firm’s performance. As privatization in China is not in the strict institutional context, the state may still interfere with the firm in a subjective manner (Bachiller, 2009).
1.2 Context and Governance Structures

There are different corporate governance contexts in different countries, which happen to change with time. There is no particular corporate governance system that suits all companies in all countries. Generally speaking, each governance system can be further classified as bank-dominated or market-dominated (Banker and Charnes, 1984). Japan and the Continental European countries are generally classified as under a “bank oriented” governance system. In these countries, market plays an insignificant role in corporate control (Boardman and Laurin, 2002). To explain this system the term “insider dominated control” is often used. This system is symbolized by comparatively constant and concentrated ownership by certain shareholders groups. In general, the market-oriented governance system is more common in the UK and USA where capital market holds a significant position in the economy.

In all these countries corporate control takes place at the heart of the control system, which is also called the “outsider control system” (Banker and Charnes, 1984). The development of China’s corporate structures seems to follow a theory that is based on the path of dependence (Myeong, 1998). According to this theory, an economy’s corporate structure is dependent upon the legal structures under which the economy grew. Corporate rules also depend on the legal structures. McConnell and Servaes (1990) argue about the dissimilarities of legal structures and their enforcement in different countries. They also explain the differences exhibited during the development of financial systems in different countries. The dissimilarities will affect a country’s financial system and consequently affect a company’s financial decision in different ways (Myeong, 1998). This leads to the argument that the financial system in any country may determine the particular governance mode which in turn affects the
relationship among the different parties involved in a particular company (Qi and Wu, 2000).

### 1.3 Governance and Separation of Ownership and Control

In the study of corporate governance, the separation of control and ownership has been identified to be central to the subject and is the focus of the research studies of many scholars (Megginson and Netter, 2001). Martin and Parker (1995) argue in their model that there are fewer firms in the world that have dispersed ownerships. Omran (2004) argues that the dominance of dispersed ownerships among firms in the US indeed reflects a competitive drawback of US firms and proposes more concentrated ownership for US firms in order to be competitive (Myeong, 1998). According to Pinto and Merek (1993), about sixty four percent of the large companies in the twenty seven richest countries have controlling shareholders and that control is frequently vested with a particular family. The study involves corporations from the developing and emerging economies and reveals the dominance of highly concentrated ownerships among corporations (Omran, 2004). However, Servaes and McConnell (1990) comment on concentrated ownership as providing too much power and authority to the controlling owner to use corporate resources for their own benefits at the cost of other stakeholders.

Agency concerns exist and differ in firms that have a controlling shareholder and firms that have dispersed ownerships (Martin and Parker, 1995). Where the degree of concentration of ownership is so high as to allow a shareholder to effectively control a firm, the agency concern becomes conflicts between the controlling and minority shareholders. Corporate decisions tend to favor the controller shareholder at the disadvantage of other shareholders (Li, 1997). However, the existence of a controlling
shareholder can pose an advantage to a firm and, consequently, all shareholders. According to LaPorta and Lo’pez (1997), those companies that are managed by a controlling shareholder tend to perform better since the controlling shareholder will have a strong incentive to ensure that capital is organized cautiously and being used in an efficient way. The need for third party supervision and monitoring costs will be reduced as a result of the incentive (Myeong, 1998). It also alleviates the concerns of free riding, and allows control to be applied more efficiently (Megginson and Netter, 2001). Firms that are associated with a particular business group may benefit from internal transfer of funds among group members to offset the inefficiencies of the capital markets. It may be argued that the benefits derived from the existence of a controlling shareholder may exceed the costs (McConnell and Servaes, 1990).

1.4 Reform of State Owned Enterprises and Ownership Structure in China

The Chinese economy has undergone a transition from a centrally planned one to a market based one; with the highest control proportion falling under the ruling party and the state (Yueh, L. 2011). It is an example of a state that has realized economic development without privatization of state-owned companies, without democracy, and without complete market liberalization (Martin and Parket, 1995). In China, it is the state owned enterprises, commonly known as “SOE’s” that are dominating the economy. Development of China’s economy has focused mainly on reforming or restructuring the SOEs. The economic reform in China that started in 1978 basically focuses on separating ownership of SOEs from state control (LaPorta and Lo’pez, 1997). The gradual separation of management control from state ownership takes the form of corporatization, rather than privatization.
Since 1992 corporatization has been widely promoted in China where corporate management is made liable for the assets of SOEs with a view to stemming the draining of state assets (Martin and Parker, 1995). Reformation of SOEs without going through privatization has created two institutional issues. The first issue arises from transferring rights of control to managers so as to increase the efficiency of production. The power vested with the managers may however prompt them to deprive of state assets (Myeong, 1998) thus leading to an escalation of agency costs. Secondly, ultimate ownership of SOEs by the state allows the government and the ruling party to interfere with management such that management efficiency is compromised resulting in higher operation costs (Omran, 2004).

1.5 Institutional Background

Countries that are undergoing economic transitions are characterized by privatization of firms. Theoretical and descriptive studies have proved that, in general, the efficiency of private firms surpasses that of state-controlled firms (Megginson and Netter, 2001). Privatization yields innovation and cost efficiency. It also improves corporate governance and competitiveness (Megginson and Netter, 2001). However, not all stakeholders may be satisfied by privatization in every context (Martin and Parker, 1995). It has been noted that loss of employment is a common undesirable result of privatization, which has an adverse impact on the popularity of politicians and governments (McConnell and Servaes, 1990). China started to embark on a comprehensive economic reform in 1978, starting with the reform of SOEs (Omran, 2004). Reform of SOEs is imperative as they had accumulated huge losses due to inefficient production and a cradle-to-grave staff welfare burden (Pinto and Merek, 1993).
TFP (Total-factor Productivity) is also known as Multi-factor Productivity. The variable is responsible for the effects in the total output that is independent of traditional input measurements of capital and labor. Accounting for all the inputs transforms the definition of TFP to refer to the long-term technological dynamism or change of an economy. Since the economic reform started, the measured TFP of SOEs has increased. Incentives for managers have improved and decision making has also been decentralized (Qi and Wu, 2000). As part of the economic reform, an important decision was made by the Chinese government to allow stock exchanges to be re-established in China after 1949. This has seen the establishment of the Shanghai Stock Exchange in 1990 and the Shenzhen Stock Exchange in 1991 respectively (Sun and Wilson, 2003). The two stock exchanges have posed a great achievement of the economic reform (Megginson and Randenborgh, 1994) despite the fact that new listings on the stock exchanges are strictly examined and directed by the government (Allen et al, 2005).

Notwithstanding the close scrutiny exercised by the authorities, listed companies have realized an increase in their number from ten to 1,430 at the start and by the end of February, 2007 respectively (Lin, 2008). Despite the establishment of the stock exchanges and the move to encourage firms to go public, the Chinese government seems quite reluctant to commit to privatizing SOEs (Sun and Wilson, 2003). Privatization of SOEs only takes the form of corporatization rather than privatization (Allen et al, 2005). Lin (2008) defines the privatization of Chines SOEs as the “retain and retreat” strategy where the state still maintains a high level of ownership in the large and strategically important SOEs, while selling out small and medium sized SOEs. Saunders and Travlos (1990) argue that the Chinese government still maintains a controlling stake in most firms in most industries in the post-reform period. The Chinese government seems to be able to contain the unfavorable social effects of privatization on employment while solving the efficiency problems of SOEs (Allen et al, 2005).
1.6 Classification of Shareholders in China

The unique feature of Chinese listed companies is that there exist five types of shares. They include: employee, legal person, state, tradable-A and tradable-B (Allen et al, 2005). Only the tradable shares can be openly traded.

1.6.1 Share Ownership

Government owned shares

Shares that fall under the ownership of the local or central government, or government enterprises are called state shares (Cheung et al, 2009). To exercise the ownership rights on firms that are state controlled, government officials are generally appointed to work as an agent (Sun and Wilson, 2003). The transfer of state shares to domestic institutions can only be possible following CSRC’s approval (Jensen and Ruback, 1983).

Legal Person Shares

The domestic institutions holding shares are called legal person shares. Two sub-types of shares exist under this category, and can be distinguished by ownership identities. They are shares owned by state-owned enterprises (SOE) and shares owned by private shareholders or non-state institutions (Saunders and Travlos, 1990). This
category of legal person shares in effect has three different ownership identities, namely, (1) privately owned enterprises, (2) state-owned enterprises, and (3) government agencies (Bachiller, 2009). With the permission of CSRC these shares are tradable.

### 1.6.2 Tradable A, B-shares, and other shares

Domestic institutions and local citizens own tradable-A shares. Foreign investors cannot own the shares and were limited to tradable-B shares. However, Chinese institutions and local citizens were also permitted to own tradable-B shares since 2001. CSRC requires that tradable-A shares must comprise more than 25% of all the shares of a company (Qian et al, 2005).

A-shares are denominated in Chinese Renminbi. They are tradable on the Shanghai and Shenzhen stock exchanges. Only about one-third of all A-shares are available for public purchase as the Chinese government still owns about two-thirds of the A-shares. Foreign investors may now buy A-shares through the QFII scheme (Qualified Foreign Institutional Investor), a programme that permits certain licensed international investors to participate in China’s stock exchanges. Tradable-B shares are traded and issued in foreign currencies, bearing their face values in the Chinese Reminbi. The first issue of B-shares was in 1992. This was meant to attract foreign capital through the capital markets of the country. The Shenzhen and Shanghai Stock Exchanges also trade B-shares, in U. S dollars (Shenzhen) and Hong Kong dollars (Shanghai). B-shares market is currently illiquid; thus the small number of its traded shares. Speculations indicate a possible merging between the A and B shares in the future.
1.7 Development of the Chinese Stock Markets

The stock market’s origin in China can be traced back to August 1984, when the first set of regulation on securities was approved by the Shanghai Municipal Government. In November of the same year, a household electronics company issued the first batch of shares. These shares became tradable on the over the counter (OTC) market in August, 1986, which was run and maintained by the Industrial and Commercial Bank of China (Franklin, Qian, and Qian, 2005). Later years experienced the incorporation of more SOEs for the purpose of selling various types of shares to legal persons and individuals (Allen et al, 2006). The stockholding system had not been an important vehicle in the reformation of enterprises that were owned by the state before Shanghai Stock Exchange’s establishment in 1990. The CSRC was established to regulate and monitor national stock markets in 1992 in a manner similar to a similar establishment in the United States (Allen et al, 2006). The Chinese stock markets had since witnessed a rapid growth. By 2013, SHX’s listing included 953 stocks; with USD 560 billion as the market capitalization (Source: SHX web site http://www.sse.com.cn. access on Oct 2013).

In 2005, CSRC announced a reform that targeted the elimination of all shares that were not tradable by the end of 2006. The reform primarily requires tradable shares’ holders to be paid by those of non-tradable shares as a consideration for obtaining the right to use the open market to sell their shares. It is expected that a more diffused ownership structure should be conducive to enabling management to run a firm professionally. This will expedite the privatization process and improve corporate governance thus leading to increase in firm value. Furthermore, the significant increase in liquidity as a result of the introduction of non-tradable shares in the open market will help promote further development of the stock markets.
1.8 Ownership Structure of Listed Chinese Companies

The structures of ownership of the listed Chinese companies have few distinctive characteristics that are non-existent in the capital markets of developed states. McConnel and Servaes (1990) categorize them as A, B, H and N shares. A-shares can further be sub-classified into: employee, legal person, tradable-A, and state shares. State shares are those shares that are owned by the local or central government or the state (Megginson and Randenborgh, 1994). Shares that are held by institutions and domestic legal entities are legal-person shares. Both the legal-person and state shares cannot be traded on the stock market, but are transferrable to a different legal person (Saunders and Travlos, 1990). Tradable-A shares are the only shares that are tradable to local investors. Only Chinese institutions and local citizens can hold these shares (Bachiller, 2009).

B, N and H shares can be held by foreign investors and also be traded. B-shares, which were initially limited to foreign investors, are denominated in Hong Kong Dollars or United States Dollars. They are only listed on the Shenzhen and Shanghai Stock Exchanges (McConnel and Servaes, 1990). N shares are traded on the New York Stock Exchange while H shares are traded on the Hong Kong Stock Exchange (Megginson and Randenborgh, 1994).

Employee shares in China are different from the ownership plan of employee stock in the United States. Accumulated profits of a company are reserved by the entity in the pre-initial-public-offering stage and are as a whole attributable to employees of the company (Bachiller, 2009). These shares are non-tradable at the listing time. They
are managed by the labor union or an investment management committee of the company concerned (Megginson and Randenborgh, 1994).

Typically, none or very little shares are owned by the management of Chinese firms (Allen et al., 2006). Chinese listed companies typically have a mixed structure of ownership. Domestic individual investors, legal-person investors and state investors are the leading and dominant shareholder groups, and each of these investor 25 groups accounted for about 30% of the total shares in China (Allen et al, 2005).

1.9 Ownership Structure and Corporate Performance

Where a firm exhibits dispersed ownership, there is no incentive for shareholders to monitor management because the benefits of monitoring are less as compared to monitoring costs (Desender, K.A., 2009). Bachiller (2009) illustrates that a firm’s performance is increased by some degree of concentrated ownership. Most studies in this area have examined data on the developed economics (Saunders and Travlos, 1990). McConnel and Servaes (1990) discover that, out of a sample of 114 firms of the American and New York Stock Exchanges under the control of a major shareholder whose percentage of the common stock exceeds 50%, the accounting profits and the Tobin’s Q are comparatively smaller for those firms which majority are small individual shareholders. The study by Saunder and Travlos (1990) study is based on the comparison between the performance of diverse enterprises, private enterprises and SOEs. The results of the research studies indicate that the performance of mixed enterprises and SOEs is worse than that of private companies by a significant margin. Bachiller (2009) argues that block holdings by institutional investors have a positive
correlation with the performance of corporate, provided the state is not the holder of the blocks.

While previous practical researches on the correlation between the performance of firms and the ownership structure in China have aided the understanding of particular aspects under firm governance, these studies still have flaws in defining the classification of ownership. The official classification is not clear in ascertaining the identity of a shareholder (Kaplan and Norton, 1992). It might not be proper to use total shares, tradable A-shares and state shares as respective proxies for legal person shareholdings, public shareholdings and state shareholdings (Harper, 2001). As a result, there remains the possibility of a delusion that shareholders with similar ownership identities may be considered as having similar interests (Kaplan and Norton, 1992). On the other hand, shareholders with similar ownership identities may still have varied interests depending on their status. For example, it is essential to discover the respective impacts of both the controlling and minority shareholders on the firm’s performance though they may be holding the same kind of shares. The effect is more significant where the status changes from a minority shareholder to a controlling shareholder (Chen and Firth, 1999).

1.10 Family Business

In the governance landscape of both the developed markets and the emerging markets, business groups play a vital role (Martin and Parker, 1995). A common view suggests that the association with a business group yields a positive transformation of the firm’s performance with regard to general market failures and poor legal/regulatory governance. Arguments based on embeddings (Myeong, 1998), exchange theory (McConnell and Servaes, 1990), the view of a firm based on its resources (Martin and
Parker, 1995) and the analysis of the costs of transactions (Li, 1997), all point to a positive contribution by business groups and reveal that the association will help firms improve performance. This is because they are able to access scarce resources, internalize market transactions, and benefit from the networking and relationship with governments (LaPorta and Lo’pez, 1997). Despite the fact that some of the research studies support the hypothesis that affiliation with business groups improves the performance of a firm (Mcconnell and Servaes, 1990), some other articles offer only mixed support, and some are found to have a negative effect (Myeong, 1998). Omran (2004) evaluates a sample of 14 emerging economies to study the effect of affiliation with business groups on the profitability of a firm and discovers that the effect is positive only for a minority of them and not one of these are in the developing markets.

1.11 Research Objectives and Questions

In this research study, I aim to evaluate the performance of listed companies in China with respect to ownership structure, ownership concentration and characteristics of the CEO. The following objectives have been established for purposes of this research study. The objectives of the research explain its purpose and aims (Zikmund et al., 2010).

- To determine the prevalent relationship between ownership structure and the performance of the listed companies in China.
- To carry out an assessment of how the structure of ownership may influence the performance of these listed companies.
- To evaluate the relationship that prevails between performance and ownership concentration of Chinese listed companies.
To assess how ownership concentration may influence the performance of these listed companies.

To evaluate the relationship that prevails between performance and CEO characteristics of Chinese listed companies.

To assess how CEO characteristics may influence the performance of these listed companies.

**Research Questions**

There are four assumptions in this study. According to Chen and Firth (1999), the first assumption is that the structure of ownership reveals the problem’s nature in agency, thus will determine the control and the distribution of power within an organization. In the developed economies the absence of a control mechanism will cause the major shareholders to function as an alternative governance mechanism as a justification of the agency’s problems (Boardman and Laurin, 2002). The incentives to shareholders will increase with the level of ownership. Shareholders that own large blocks of shares tend to monitor management closely in an attempt to secure their investments (Chen and Firth, 1999). Everything else being constant, agency costs may reduce due to concentration of ownership (Harper, 2001). Accordingly, lower costs of monitoring will lead to better performance, which is in favor of all shareholders (Kaplan and Norton, 1992).

The second assumption is that an increase in control and monitoring, through the participation of owners at board level, will reflect a reduction in costs (LaPorta and Lo’pez, 1997). Negative information is reduced and control more efficient as more information is obtained through the directors on the board (Li, 1997). In cases where
the owner is a member of the board, a better control mechanism is created. The correlation between corporate performance and owner involvement tends to be positive (Boardman and Laurin, 2002). Dabler and Davie (2002) argue that because controlling shareholders will oversee and monitor management performance to make sure their interest is protected, positive firm performance is ensured.

The third assumption is that a firm will have to look for different alternative sources to meet its financial needs when there is no liquid capital in the markets. A potential way to resolve the problem will be by the affiliation with other companies within the same group (Kaplan and Norton, 1992). For example, the banking affiliation of a business group to which a company belongs could be considered as an internal capital market which will help the company meet its financial needs (LaPorta and Lo’pez, 1997). Everything else being equal, a firm will have easy access to capital sources and will offer lower financing costs thus helping improve the performance of a firm (Dabler and David, 2002).

The fourth assumption states that a firm’s performance is directly affected by its size as a result of economies of scale. Large firms may have better allocation of resources and can thus reduce transaction costs (Charnes and Rhodes, 1978). Consequently, larger firms are expected to have better performance and better bargaining power in competing for vital resources of a firm (Boubakri and Jean, 1998). Chen and Firth (1999) argue that large firms may perform better as compared to independent and smaller firms, as large firms can transfer resources with more flexibility among firms of the same group.
All the four assumptions are based on the agency theory (Dabler and David, 2002). Research questions are the translation of the research problems into specific enquiries (Zikmund et al, 2010). They are refined statements of the specific components of the problem (Malhotra, 2010). A well stated research question guides the researcher to stay on track and indicates what data to be collected in response to the questions.

Listed below are the questions that the research aims to answer:

1. Is the structure of ownership significantly associated with the performance of Chinese listed companies?
2. Is the ownership concentration significantly associated with the performance of Chinese listed companies?
3. Are the CEO characteristics significantly associated with performance of Chinese listed companies?

1.12 Correlation between Performance and Ownership Structure

Villalonga and Demsetz (2001) are for the argument that there is no significant correlation between ownership structure and performance among the listed firms in New Zealand. They recommend that economies of scale, stability of the environment and regulations should form the basis of the structures of ownership. However, there exists a non-linear relationship between the structure of ownership and the performance of the firms in New Zealand. Furthermore, the top 20 shareholders in New Zealand hold a mean stock proportion of 73%. This is an indicator of the prevalent high concentration of New Zealand’s firms, hence necessitating the need for increased monitoring to avert cases of managers’ entrenchment (Rao, Hossain and Prevolt, 2001). Between 2007 and
2011, the mean stock proportion of the top 20 shareholders is 46.73\%. This indicates that the concentration of ownership of New Zealand firms tends to be moderate.

Minimal quotas have been imposed for the representation of female individuals on the boards of firms in Norway and France. Ferreira and Adams (2009) identify that increased monitoring is prevalent among firms whose boards are characterized by high gender diversity. With regard to the firms that exhibit minimal rights for the shareholders, there exists a negative correlation between female representation on the board and a firm’s performance. Besides increasing the pool from which potential managers of the firm can be selected, an increase in female representation on the board of directors also yields additional skills and expertise that could not have been available in the event of a board that entirely comprises the male gender of individuals.

The correlation between a firm’s performance and its ownership structure remains inconclusive (Kim, Taylor, and Dennis, 2013). This may partly be explained that a general pattern may exist only within a specific boundaries or limits. How to determine and where the limits stand may provide an incentive for further studies. However, the relationship between a firm’s performance and the characteristics of the CEO for Chinese listed firms is an area that has not been covered comprehensively and is worthy of further study. This is probable due to the fact that professional CEOs are just starting to play a more significant role in Chinese listed firms. It is anticipated that going forward the role of the CEO in Chinese companies will become more significant although most Chinese listed companies, both state and privately owned companies alike, still have a controlling shareholder. How the CEOs of Chinese listed companies discharge their duties in a heavy ownership concentration situation where the controlling shareholders are still actively involved in company operations and decisions will be an interesting topic for further study.
1.13 Specific Environmental Context

Previous research studies on the correlation between ownership and firm performance are mostly based on advanced economies; such as the UK and USA (Kim and Chung, 2008). The outcomes of such research studies may not be able to be generalized to the developing economies. Despite the few studies done on Asian countries by certain researchers, such as Daßler and David (2009) on South Korea and Harper (2001) on China, reference is still limited. In general, the entire chapter lacks articles published in recent years and this is a serious constraint. There are a number of advantages for undertaking a study regarding China because it addresses the issues of governance as it relates to the emerging and developing countries (McConnell and Servaes, 1990, p. 595). First and foremost, the average growth rates of China’s GDP were 9.2%, 10.4%, 9.3% and 7.8% respectively for the years of 2009, 2010, 2011 and 2012 (World Bank).

Secondly, the Chinese government has since implemented new regulations to provide a basic legal framework for regulating corporate activities (Rachel, 2011). It is considered that China is a good representation of most of the global countries that are in the developing stage, based on its dependence on external financing and the prevalence of family businesses (Kaplan and Norton, 1992).

1.14 Research Paradigm

The theoretical basis upon which this research study is conducted is about the relationship of agency hypothesized by Jensen and Ruback (1983). The association
among the different parties within a firm will be observed from the agreement that is contractual in nature and which defines the obligations and the rights of each party. On the other hand, due to the uncertain future, the contracts will be incomplete. This incomplete nature of contracts will allow corporate behavior to deviate from the maximization of value (McConnel and Servaes, 1990). The agency theory suggests that the owners of financial capitals are the shareholders and they are not owners of a firm (Meggison and Randenborgh, 1994). As a result, a separation of control and ownership does exist because the capital owners entrust control of a firm to the board of directors and decision making to the managers.

Under this perception, it is necessary to delegate the authority within a hierarchical relationship so that tasks can be completed (Saunders and Travlos, 1990). This research is drawn on functionalist paradigm that comes under the broad umbrella of the objectivist perspective from Banker and Charnes (1984). This hypothesis is characterized by an objectivist point of view, according to Saunders and Travlos (1990). Under the functionalist concept, the structures of an organization tend to shape actions of the members of the organization in reasonably deterministic ways. In addition, it is also observed that outside rules and regulations preside over the outside world, and the objective of the researcher is to look for the order that prevails under the circumstances. This research is meant to understand the stability, order and equilibrium in society and to find the ways through which they can be maintained (Boardman and Laurin, 2002).

1.15 Research Methodology

Quantitative methods have been adopted in this research study to test the hypotheses that are derived from the research questions identified. Specifically
regression analysis has been used to evaluate if there exists a statistically significant relationship between the performance of Chinese listed firms and each of the factors of ownership structure, concentration of ownership and CEO characteristics. The performance indicator adopted in the study is Return of Equity (ROE). All firms listed on the Shanghai and Shenzhen Stock Exchanges for the period from 2010-2012 are included in this research study to reduce the possibility of sampling errors.

1.16 Research Results

Results of the quantitative analysis show a positive relationship between the performance of a Chinese listed firm with respect to ownership structure, ownership concentration and CEO characteristics. The relationship, however, is valid only within certain boundaries and under certain conditions. The results are in general in line with previous studies and can be explained from a descriptive angle.
CHAPTER 2: LITERATURE REVIEW

This chapter provides a comprehensive review of the literature relating to corporate governance with respect to which the performance of the Chinese listed companies is evaluated. It starts with a description of the various theories that aim to explain firm performance before proceeding to explain the unique features of the ownership of Chinese listed companies. The role the CEO and its impact on listed companies is discussed as it relates to the performance of Chinese listed firms.

2.1 Macro Level Studies

2.1.1 A Multitask Theory of State Enterprise Reform

This theory aims to explain the reasons for the low rate of return in state-owned enterprises (SOEs) and why their performance is poor in all transitional economies. According to this theory, there is an initial observation that social stability is achieved by the setting up of a social security net during the transition period. This is crucial to an economy since social instability may cause unemployment and an unstable business environment, which lead to reduction in overall efficiency. During the transition stage, SOE’s reforms are slowed down by the government so as to maintain a particular number, thus achieve the stability of the economy. The SOEs that remain are charged with many responsibilities such as production and the provision of social welfare (Bai, 2000).
Since a high proportion of the workforce is maintained by the SOEs, the Chinese government still maintains a significant number of them for social stability purposes. Therefore, the pace of reform is slow and there is slow though steady progress in reducing in the number of firms in this sector. A stylized model is used to demonstrate the multitask theory and three sets of results have been formulated. The government should maintain a certain number of SOEs when social security is at a low level during the transitional period. Moreover, the reason the SOEs have low profit incentive is that the government has set a low target for them. They are in effect not profit-oriented. Their financial performance is therefore poorer than that of private enterprises. Their main responsibility is to maintain social stability. Finally, the government should speed up the process of privatization when the level of total factor productivity is lower or the level of social stability is higher in SOEs than in private enterprises. In order to solve this related problem between SOEs and social stability, the establishment of a self-regulating social security system separate from the SOEs is needed.

Management practices and leadership is relatively weak in SOEs since they need to divert some resources for social security purposes. The multi-task purpose could be better served following the establishment of a social security system that is independent of external influence. The system will relieve the SOEs of their social security responsibilities and hence improve their performance. When profit incentive increases, the economic benefits and overall efficiency will also increase.

2.1.2 Institutional Theory

The institutional theory explains a firm’s performance in the transitional economies. There is a variety of institutional forces in a transitional economy, as China
has experienced in the past two decades. Institutional theory points to the necessity to examine organizations based on given market or social environments. The norms, values, and implicit assumptions about what constitutes acceptable economic behavior influence how firms are organized and operate (Pan, 1999).

As the forces are changing rapidly during the transition period, firms have to adjust with respect to legal and regulatory environments. The institutional framework shows that a firm’s performance depends on many factors one of which, for SOEs, is state influence. There is a need on the part of the government to ensure the maintenance of a balance between the other institutional demands and SOEs in terms of economic performance. Reducing state interference is a gradual process implying that SOE reform is a long process in China. In measuring firm performance, these non-economic factors may diffuse the effect of management practices and leadership. Profit maximization is another important issue for firms operating in a market economy. This also applies to SOEs as they need to improve so as to satisfy market needs as well as the economy in transition.

2.1.3 Agency Theory

The agency theory shows that different stakeholders such as employers, employees and clients of a firm have different agendas in a firm’s pursuit of maximization of value. These people might not have a common objective of maximizing the firm’s profit. Emergence of conflicts is fueled by selfish interests of the stakeholders that are not geared towards maximizing the firm’s value, but are rather aimed at increasing their own wealth at the disadvantage of other pertinent members of
the firm. Under such a scenario, the firm’s value cannot be said to be maximum (Jensen, 1976).

This theory explains how the owners react and what they want to do against the profit maximization goal. Agency theory has two important implications with respect to the reformation of SOEs. The first relates to the division of ownership and management within the SOEs, and the second to the possibility of applying western management practices in running the SOEs. The first implication suggests that it is impossible for all investors to run a firm. Thus, there is the need to hire a management team to run the operation. The second implication recommends that firms follow the western mechanism such that SOEs are run as public listed companies to increase profit and efficiency.

The ownership of public listed companies lies in the hands of individual shareholders. If the company does not perform well, owners sell the stocks and its price falls. If the state is the sole owner of SOEs, it does not have the similar mechanism to ensure the performance of firms (Pan, 1999). As reforms of SOEs proceed, ownership of the state properties will transit to those with better capabilities. This explains why there is a big difference in management practices and leadership among SOEs, private enterprises and foreign-funded enterprises.

2.1.4 The Industrial Organization theory

The industrial Organization theory explains the movements of direct investment (FDI) by foreign funded PEs in the transitional period. This theory was found by
Stephen Hymer in the 1960s. It facilitates the oligopolistic firms to extend into foreign markets through FDI and to close out market competition by the erection of entry barriers. It is important for a foreign funded enterprise to achieve operational advantages in order to compete with local enterprises. They need to build a competitive edge through possessing advanced technology, sufficient capital, capable management team and superior marketing skills. This also applies to foreign funded enterprises that invest in China. According to Hymer, when directly investing abroad, multi-national corporations face disadvantages, such as information risk and uncertainties associated with running a firm in an unfamiliar foreign political, economic and social system, when it comes to competing with indigenous firms (Lai, 2002).

2.1.5 Neoclassical Theory

The neoclassical theory of foreign investment (Allen, Qian, and Qian, 2004) provides an explanation based on the Heckscher-Ohlin-Samuelson (HOS) model regarding the international movement of factors of production including FDI. Capital movement is basically determined by different proportions of primary production inputs available in various countries. In terms of the FDI, capital flows from the country where capital is relatively abundant or there is lower marginal productivity to the country where capital is relatively scarce or where there is higher marginal productivity. The theory acknowledges that capital movement is beneficial for both the source and host countries. The host countries may benefit more from the FDI than the investing countries from a marginal return.
2.1.6 Location Theory

The Location Theory explains that FDI movement is determined by two subdivisions of both the source and the host countries including input-oriented location factors and output-oriented location factors (Sun, 1998, and Allen et al, 2006). Input-oriented factors are the supply variables of production such as labor cost, raw materials, energy and capital. Output-oriented factors are primarily focused on the determinants of market demand consisting of population size, income level and openness of market in the host countries. All of these country-specific factors not only directly determine the location choice of FDI but also account for the type of FDI such as market-oriented or export-oriented.

2.1.7 Eclectic Theory

Dunning (1983) developed Eclectic Paradigm to combine three previously mentioned theories namely Industrial Organization Theory, Location Theory and Internalization Theory so as to interpret FDI development and international production (Ray et al, 2003, and Wang, 1996). Dunning (1983) argues that these three theories are compulsory for interpretation of the FDI and also lists three major criteria that are prerequisites for overseas investments. Firstly, enterprises must possess net ownership advantages over their competitors in the host country’s local market. Secondly, the investing firms must be able to maintain ownership advantages internally rather than selling or licensing them to foreign enterprises. Thirdly, location factors of the host countries must be more beneficial than those of the source countries.
Pan (1995) examines the determinants of foreign equity ownership in joint ventures in China drawing upon Dunning’s locational, ownership and internationalization paradigm and finds that the level of state ownership of the Chinese partner has an impact on the level of foreign control in a joint venture.

Dunning (2001) re-formulated the eclectic paradigm to account for the cooperative relationships that are typical of ‘alliance capitalism’. In his revised eclectic paradigm he recognizes that international business activities can sometimes be organized more efficiently in cooperative inter-firm networks and alliances. This cooperative relationship is commonly found in Asian firms.

Erdener and Shapiro (2005) use Dunning's eclectic paradigm of multinational enterprise to examine Chinese family businesses. They focus on these family businesses’ distinctive international competitive strengths as well as their international expansion strategies. They argue that the international Chinese family business which are characterized by concentration of ownership and management as well as inter-firm networks and alliances is an effective organizational mechanism that enables them to achieve competitive and locational advantages.

2.1.8 Internationalization Approach

This approach explains that FDI is a way for minimizing market imperfection such as regulatory aspects including tariffs, foreign exchange controls, import quota and income taxes which can substantially increase transaction costs. It explains how MNCs achieve operating efficiency and reduce transaction costs through internalizing their
economic activities. Internalization is a strategy for MNCs to minimize transaction costs, maintain market share and hold the power for maximizing firms’ benefits. The Internalization Theory is a model of private welfare maximization based on an MNC’s operation (Sun, 1998 and Faccio et al 2001).

### 2.2 Ownership Structure

LaPorta and Lo’pez (1997) use the proportions of shares that are owned by significant stakeholders of the firm for measuring ownership structure, with the focus on the shareholders who have the five largest fractioned ownerships. Subsequent research studies focus on the share proportion owned by the managers of the firm. Management holdings encompass shares held by senior management, the CEO and board members. There has been an exclusive reliance on this measure for tracking the severity of the problems in agency, problems which are perceived by all other shareholders. Such holdings are classified as common interest of the management (Harper, 2001). Members of the board may obtain their position on the board by virtue of their representing a large shareholder in the company (Kaplan and Norton, 1992). Members of the board do not necessarily have the same interest as the professional management.

LaPorta and Lo’pez (1997) use the Herfindahl index to assess the concentration of shareholdings and fractions of shares for the top shareholders. Although they also suggest that the interest of institutional investors may be different from those of individual investors, large shareholders somehow ignore the difference between institutional and individual investors. LaPorta and Lo’pez (1997) opine that the possible problem is related to the measurement of a firm’s ownership structure. The relative shareholdings of shareholders of large corporations are not considered to be authentic.
measurements of the extent of protection of interests these investors can provide to fend off management’s incentive to control a company. Management sometimes holds shares as a shareholder (Cheng et al, 2005).

Empirical evidences have shown that no individual senior management members of listed companies including the CEO or CFO have sufficient shares to put them into the 5 most substantial shareholders of the organization (McConnell and Servaes, 1990). Out of 238 firms studied, 138 firms are found to be owned less than 3 per cent and 195 firms are found to be owned less than ten percent, by management. The large shareholder generally has a family member involved in top management (Clarke, 2003 and Megginson et al, 1994). It may be argued that where the 5 largest shareholders hold a significant fraction of shares, they tend to control the management and use their management role to derive benefits at the expense of shareholders (Megginson and Netter, 2001).

2.3 Ownership Structure and Firm Performance

Literature related to the effects of ownership structure on a firm’s performance and strategy can be divided into three areas (Neely and Gregory, 1992; Chen and Peng, 2001). This research study aims to study the effect of ownership by the state to the company’s performance with regard to accounting and marketing and the behavior of corporate policies. The state accounts for the highest proportion of shares in the companies. State ownership is a main channel through which the government may interfere with management. This research study will also study the impact of legal person’s shareholdings to the performance of the firms that were listed in the study. The freedom given to legal persons surpasses that of state shareholders terms of making
decisions on investments, disposal of assets and allocation of profits (Omran, 2004). They are also considered as more profit oriented. In a similar way, Chen (2005) examines the structure of ownership and firm’s performance of Indian firms by classifying macro investors to either belong to investors of private institutions and local financial institutions held by the local government and finds that there is a positive correlation between investor interests in private firms and the firm’s profitability. Delios and Wu (2005) find similar results in the effects that board size and ownership structure have on Indian firms. They discover the existence of a positive correlation between a firm’s market value and the degree of foreign investors in the firm. Moreover, the board’s size positively affects the firm’s value, whereas the ownership by directors is negatively correlated with the firm’s value.

Allen and Qian (2005) consider dispersed ownership and a governance system as an effective way for the prevention of asset appropriation. Chen (2005) examines the effect of ownership structure and board composition on financial fraud in the corporate sector and finds that board structures and ownership have an effect on corporate fraud. She also discovers more external directors and board meetings and longer CEO’s tenure result in a positive effect in terms of preventing corporate fraud in Chinese firms. The results of the above empirical studies reveal a relationship between the shareholdings of a legal person and the firm’s performance. In this dissertation, one of my focuses is on studying the effect of ownership concentration on firm performance as concentration of ownership is considered a general feature of Chinese firms (Ru, 2006; Pinto and Merek, 1993).

Sami et al (2011) argue that better corporate governance will lead to better performance and investigate the impact of corporate governance on the performance and valuation of Chinese listed firms. They find that corporate governance is positively and
significantly associated with firm performance and valuation. They show that ownership concentration and board independence also have a positive impact on firm performance and valuation. In addition, they discover that a firm’s value increases with foreign ownership while firm performance decreases with state ownership.

2.3.1 State Ownership and Firm Performance

By 2011, there were approximately 34,530 state-owned enterprises in China. Compared with 2010, there was a decrease of 18.7% in the number of enterprises in this particular sector. 76.4 million individuals were employed in the whole state-owned sector. The numbers had dropped due to the reduction in the number of SOEs. The amount of investment in fixed assets by SOEs still accounted for the majority of such investments among the SOEs, Private Enterprises and Foreign-funded Enterprises. The growth of SOEs’ investment, however, has decreased, especially in the past decade (Ru, 2006).

The performances of SOEs and the non-state enterprises go in different directions. The performance of a firm is often determined by productivity and efficiency. The performance of the SOEs has been deteriorating, while that of the private and foreign-funded enterprises is improving. This particular section discusses the problems and challenges that SOEs are facing, such as unfavorable competition in the market, failure of the transferring scheme, increases in levels of unemployment, mismanagement and uncooperative management structure (Hovey, 2006).
Because SOEs are not operating under strict commercial principles, they are less competitive in the market place. SOEs are loaded with different burdens. These burdens include overstaffing of the organization, extra welfare costs and increasing costs of making provision for retirement pensions. For example, the proportion of administration staff to workers is so high that in 2012 approximately 25% of construction SOEs suffered from overspending on overhead expenses that amounted to 20 billion RMB. When these enterprises utilize extra resources to cover overhead expenses, the opportunities for developing the mainstream business is compromised. Since the SOEs employ the majority of the workforce, this overstaffing problem in turn affects their performance. This is another serious problem among SOEs, with funds that should otherwise be applied to improve performance being misplaced. Therefore, these constraints in an unfair competitive environment reduce productivity and efficiency resulting in losses to SOEs (Xin, 2005).

There is one characteristic of China’s SOEs that negatively affects the overall performance of the enterprises in this particular sector. From a resource utilization perspective, the transfer of profits made by the better performing SOEs to subsidize the loss making SOEs results in resources being inefficiently deployed. The better performing SOEs have less retained profits and incentive to create additional economic returns while the loss making ones have pressure to improve performance.

Property rights theory and agency theory on costs form the basis for this dissertation that studies the correlation between state ownership of a firm and its performance, with respect to the argument that private firms are more efficient than their public counterparts. Shleifer (1998) and Hart et al, (1997) affirm the preference of private ownership to public entities after finding out that 50 SOE managers did not have proper strategies to either increase the quality or minimize operational expenses.
Boycko et al. (1994, 1996) argue that SOE’s widespread inefficiency emanates from the quest for individual objectives of the politicians that are assigned the responsibility to control them. Boardman and Vining (1992) indicate that the profitability of enterprises of mixed ownership form surpasses that of state-owned enterprises despite that they are far from matching private corporations (Boubakri, Cosset and Narjess, 1998; Gallal et al, 1994; Meginson et al, 1994; Berger et al, 2007). Megginson and D’Souza (1999) indicate that a firm’s operating and financial efficiency increases when the firm’s ownership and management is passed from public to private hands. However, the available evidence for the favor that is granted to private firms is still inconclusive. Interestingly, according to Meyer (1975), Bruggink (1982) and Neuberg (1977), state-owned firms are more efficient that private firms.

In addition, there are two conflicting views regarding state ownership. The first view states that a firm’s performance is negatively correlated with state ownership as the state takes up the social security burden. Another perspective stresses on the significant role of state ownership. Qi and Wu (2000) argue that government ownership positively impacts the performance of a firm since the government by virtue of its ownership effectively sends positive business signals to the market and is actively involved in the management, monitoring and providing direct and indirect subsidies. Results of previous empirical studies have so far not been able to identify a clear relationship. Qian and Tong (2002) study the 280 companies that were listed in China between 1993 and 1995. Their studies indicate a negative correlation between the firm’s performance and state ownership. However, they fail to find a similar relationship when they use the dependent variable, market-to-book in the analysis. According to Robert (2003), there is a negative correlation between a firm’s performance and state ownership when he uses the market-to-book variable in the study between 1994 and 2000. Those studies however all fail to find significant results when the dependent variables are changed to earnings-before-interest-and-tax and return on sales (Shanghai, 2005). Many previous
studies suggested the existence of a non-linear regression between a firm’s performance and state ownership. Tang (2006) study 2,660 firms from 1994 to 1998 and conclude that a U-shaped relationship exists when state ownership is negatively associated with corporate value, but a positive effect beyond the threshold. In a similar study, Sun and Huang (1999) study Chinese listed firms for the years from 1994 to 1997 and find that an inverted pattern, a U-shape one, prevails between government ownership and firm performance.

Yu (2013) studies non-financial listed Chinese firms between the period 2003–2010 to examine the relationship between state ownership and firm performance and finds that there is a U-shaped relationship between state ownership and firm performance. The findings reveal that a higher level of state ownership has a stronger positive impact on firm performance than a dispersed ownership structure. Yu ascribes this observed result to stronger government connections and support for firms with high level of state ownership.

### 2.3.2 Legal Person Ownership and Firm Performance

It is generally accepted that legal person shareholders have a strong effect on firm profits and have more liberty in strategic decisions of a firm than state shareholders. The enhanced management autonomy, which comes from China’s enterprise reform results in insider control (Allen et al, 2006). In such a situation, the legal person shareholders have been considered more effective in checking and monitoring management.
Wu (2005) argues that there is a positive correlation between a firm’s legal person ownership and its profitability. The results indicate a U-shaped pattern between the market value and legal person ownership when using the market-to-book ratio variable in the analysis (Kim and Taylor, 2013). Liu (2005) studies listed Chinese firms for the period from 1994 to 2000 and uses return-on-sales and market-to-book value ratio to be the dependent variable and finds a direct correlation between firm performance and legal person ownership. Shanghai (2005) identifies a U-shaped pattern between Tobin’s Q and legal person ownership by studying the listed companies on China’s two stock exchanges for the period from 1991 to 2001.

2.3.3 Ownership Concentration and Firm Performance

Multiple studies exist about the influence that concentrated ownership bears on the performance of a firm. Chen, Firth and Xu (1999), and Rui (2005) argue that monitoring roles are directed to large shareholders since they bear the monitoring incentive. The hypothesis of strategic alliance states that the cooperation of large shareholders with the board increases its efficiency. Singh and Davidson (2003) show that agency costs are more effectively controlled using block ownership. Harper (2001) opines that large shareholders possess the ability to reduce free-rider problems in an organization that has many individual small shareholders. Concentrated ownership creates incentives for the major shareholder to monitor and check the management hence leading to a positive increment in the ownership value. Li (1997) finds that among firms in China, large shareholders play a significant role in corporate governance as they check management and effectively prevent serious agency problems. Martin and Parker (1995) use the share percentage of the top ten stockholders as the dependent variable. Their results show a positive correlation between firm performance and
ownership concentration (Yin, 2007; Megginson et al, 1994) view a U-shaped pattern between Tobin’s Q and the shareholdings of the largest investors in a firm.

Study by Xu et al (2006) reveals a linear relationship between firm performance and ownership concentration. They find that an incentive, rather than entrenchment, effect exists for the largest shareholders and that the positive effect is highest in the listed companies controlled by SOEs affiliated to the central government. They argue that having outside block shareholders will lead to lower firm performance although the magnitude of the effect seems to depend on the nature of the outside block shareholders.

2.3.4 Family ownership

Family ownership is an important property that influences corporate governance (Juliarto, 2012; Anderson and Reeb, 2003; Villalonga and Amit, 2006). Findings from many studies on family firms in the developed countries indicate that management creates greater motivation if the firm is owned and managed by family members as the managers are eager to optimize company value, thus creating a positive impact on firm performance (Chan and Chung, 2012; Anderson & Reeb, 2003; Demsetz & Lehn, 1985; Miller et al, 2008). Family members may dominate a company either through ownership or management or both. The influence of ownership structure on decision making in family business is always a key issue (Peng & Jiang, 2010; Pukthuanthong et al., 2011; Villalonga and Amit, 2006). Family businesses in the emerging economies usually have a founding family who either exercise direct control through a majority ownership or through a pyramidal ownership structure (La Porta et al, 1999 and 2002; Claessens et al, 2000; Morck et al, 2005; Almeida and Wolfenzon, 2006; Young et al, 2008; Chan et al., 2012).
According to Chan and Chung, (2012), there are two forms of ownership structures of family businesses. They are direct ownership structure and pyramidal ownership structure. Both ownership structures have an impact on the business strategy and the power of the family groups (Claessens, Djankov, Fan and Lang, 2002; La Porta et al, 2002; Kim and Sung, 2009). From an agency theory perspective, different family ownership structures lead to different co-ordination and control mechanisms (Fama and Jensen, 1983; Demsetz and Lehn, 1985; Chan and Chung, 2012). The key issue in agency theory is on how to minimize agency costs (Hovey, 2006). This may be achieved through incentive contracts or a proper monitoring mechanism (Jensen and Meckling, 1976; Fama and Jensen, 1983; Eisenhardt, 1989; Sanders and Hambrick, 2007). Family owned enterprises rely on trusts among family members in managing the business and in addressing uncertainties and risks (Anderson and Reeb, 2003; Cruz et al., 2010; Print and Reynolds, 2012). Since family members do not have to answer to outside shareholders, their key objective is to primarily create wealth for the family. Family members tend to follow the instructions of the family group leader. The needs for monitoring tends to be less as family members’ interests are aligned, as compared to their public company counterparts (Arregle et al, 2007; Gómez-Mejía et al, 2007; Chan et al, 2008; Cruz et al, 2010).

Previous studies show that if a founding family has a controlling interest in a firm, the family will serve as a good steward of the business. The interests of the family members are aligned and family members are inclined to unify when it comes to monitoring externally appointed managers. Agency problem tends to be less serious in family owned firms (Anderson and Reeb, 2003; Chan and Chung, 2012). Trust relationships play a key role among family members in managing a family business. This helps reduce the need for monitoring as family members have a common goal
which is to increase family wealth (Fama and Jensen, 1983; Cruz et al, 2010; Chan and Chung, 2012). Applying this logic under the agency theory, it may be argued that the performance of a family owned firm is a function of the leadership of the family (Claessens et al, 2002).

Under a pyramidal ownership structure, the founding family can exercise control through levels of immediate holding companies (Almeida & Wolfenzon, 2006). A pyramidal ownership structure allows a founding family to control a chain of affiliate companies with a relatively small investment (L Porta et al, 1999; Chan and Chung, 2012). Through a pyramidal ownership structure, family members can use minimal investment to control a much bigger group of companies (Chang, 2003; Morck et al, 2005; Kim & Sung, 2009; Chan and Chung, 2012). Where external funds are more expensive or are not readily available, the founding family can make use of funds held by the different affiliate companies to meet their own financial needs (Almeida & Wolfenzon, 2006; Young et al, 2008; Chan and Chung, 2012).

As family owned businesses develop in size and continue to diversify, other management issues such as coordination and arrangement control also arise (Claessens et al, 2002; Levy, 2009; Chan and Chung, 2012). These problems become more acute when the group becomes bigger and needs more members to join management than the family can provide (Morck, 1996; Morck et al, 2005). Compared to a direct ownership structure, the investment risk to the family group is relatively less under a pyramidal family structure (Morck, 1996; Estrin and Tian, 2005; Chan and Chung, 2012). A pyramidal ownership structure offers more incentives to the founding family than a director ownership structure because it spreads the risks (Almeida & Wolfenzon, 2006; Levy, 2009; Chung, 2012).
Delios and Wu (2005) study firms that are family controlled in East Asia and discover that firms owned by family tend to face more severe constraints in financing that may limit investment opportunities of the firms. Chen (2005) compares the non-family controlled and family controlled companies of Standard and Poor 500 and finds that agency problems tend to be less in family owned enterprises and there are a greater percentage of cash flows and voting rights. Lin (2008) tries to find out the effect of ownership structure on firm value by studying companies in eight East Asian countries and discovers that the returns on stocks are lower for those organizations whose managers have greater control rights.

In a similar way, Ruan and Tian (2011) study data on 5,829 Korean companies for the period from 1993 to 1997 and find that firms tend to have lower profitability when ownership and control are separated. Bai and Qiao (2004) find that there is a correlation between market valuations and corporate governance practice among Chinese listed companies for the period from 1991 to 2001. Similar results are also achieved by Cheung et al (2009). A positive relationship is also identified between ownership concentrations and market valuation and there prevails a negative relationship between market valuation and duality of CEO and Chairman (Liao and Young, 2012).

2.3.5 Institutional ownership

Institutional investors play a major role in monitoring management actions (Shleifer and Vishny, 1986, 1997; Agrawal and Mandelker, 1990; Heenetigala, 2011).
In general, it is argued that institutional shareholders can help reduce agency costs. Chinese firms are not up to the level where institutional investors own substantial shareholdings as is the case in the U.S. and Europe. As a result, it is practically difficult to test their relationship with agency costs directly (Rui, 2008). In the context of China, the closest match to institutional investors is legal-person shareholders. The existence of such large legal-person shareholder blocks may be considered as a proxy for institutional investors in the western context (Li et al, 2008). These shareholders have the resources to analyze listed companies, and, given their substantial economic interests in the companies, have the incentive and potential to force companies to reduce agency costs (Rui, 2008).

The impact of institutional ownership on a firm is affected by whether institutional shareholders engage in activism (Moreira et al, 2013). One branch of the literature takes the view that institutional investors are better monitors than investors in general. Cornett et al (2007) find in their study that there is a positive correlation between the number and the respective percentage ownerships of institutional investors and operating performance of large firms. However, this relationship exists only for pressure-insensitive institutions. Chen (2005) discovers that only concentrated ownership by independent long-term institutions is positively correlated with post-merger performance.

Institutional investors benefit from their privy information as a result of their monitoring efforts but they do not engage in short-term trading and tend to make long-term portfolio adjustments. They sell only before very bad outcomes. Delios and Wu (2005) find that firms with higher institutional ownership record better earnings. Bai and Qiao (2004) discover that stock prices lead earnings higher when institutional ownership is higher.
Ruan and Tian (2011) discover that institutional ownership is positively correlated with firm value, and this relationship is stronger for firms with higher discretionary cash. Institutional ownership control and board ownership are also correlated with firm value. Wong (2006) identifies a spillover effect in Korea. Upon the first ever targeted challenge by an activist institutional investor in Korea, non-targeted firms with poor governance see a positive price reaction to their stocks. Ruan and Tian (2011) examine the return on a focused portfolio at different horizons, and find that activism increases shareholders wealth by $3.1 billion through announcing gains between 1992 and 2005. La Porta and Florencio (1997) find that firm size and institutional ownership are positively correlated with the probability of being targeted.

Many studies document the impact of institutional ownership on innovation as a major source of competitiveness and long-term value. Chen (2005) finds that institutional ownership is not enough to influence research and development expenditure alone and that activism is also necessary. Research and development outputs do not increase directly because of activism but because of the effect of activism on research and development inputs. Allen and Jun (2005) show that institutional ownership and innovation are positively correlated, and the impact of institutional ownership is stronger when there is more competition in the product market. Bai and Qiao (2004) discover that management is most encouraged to innovate either when there are strong anti-takeover laws or when there is a strong market for corporate control. Monitoring is most useful in inducing management to innovate between the two extreme cases. Delios and Wu (2005) argue that the degree of ownership by institutional investors would affect the level of corporate expenditure for property, plant and equipment and research and development.
While there are ample empirical evidences that institutional investor activism enhances firm value in various ways there are also findings against institutional investor activism. Delios and Wu (2006) conduct a study using Swedish data and find that portfolio managers engaged in activism in large firms with high institutional ownership that have frequent media exposure do not try to improve firm performance. In another study Delios and Wu (2005) study the firms in the Focus List of the Council of Institutional Investors (CII) and find few evidences of effective activism. La Porta and Florencio (1997) find that the "CalPERS effect" at the announcement date is visible, but the long-run effect is limited to 6 months after the announcement in the Wall Street Journal. Nelson (2006) confirms that the "CalPERS effect" originally existed, but after adjusting for some methodological issues in the previous literature, there is no continued CalPERS effect. CalPERS is the short form for The California Public Employees’ Retirement System. It is well known for pushing for shareholder activism. Stocks identified by it may perform better than other stocks. This effect is known as "CalPERS effect".

Another dimension of the impact of institutional ownership on firm management and performance is the potential short-term focus of institutional investors. Allen and Jun (2005) find that institutional investors with a short-term investment focus or with high fiduciary standards, prefer short-term earnings over long-term firm value and tend to overweigh short-term earnings and underweight long-term value. Bai and Qiao (2004) discover that the board of directors of firms with a high level of transient investor holdings tends to decrease cash bonuses whereas in a subsample of firms that are close to a zero-earnings benchmark, their boards tend to increase the cash bonus incentives. They interpret this as suggestive of boards optimizing the trade-off between current earnings and long-term firm value by mitigating the myopic incentives induced by transient investors when they are too strong, and by supplementing the current earnings incentives when they are not strong enough.
2.3.6 Foreign ownership

Investors in a foreign jurisdiction are exposed to more risks than in the home country. The risks are even higher when investing in transition economies (Rui, 2008). Political uncertainty, information asymmetry, and inadequate legal protection are the usual risks associated with investing in a foreign jurisdiction (LaPorta et al, 1999; Lins, and Karl, 2000). For cost and local market reasons, foreign investors tend to place great emphasis on the local management to run the companies. From the foreign invested companies’ perspective, they are under tangible and intangible pressure in efficiency improvement and agency costs reduction from foreign investors who usually pay a cost to be involved in a foreign market (Anderson et al, 2001; Chan and Chung, 2012). On the other hand, geographical distance, unfamiliarity with local ethos and lack of local market knowledge may compromise the influence of foreign shareholders in monitoring the management, resulting in achieving little effect on reducing agency costs (Boardman et al, 1994).

Some researchers have compared foreign ownerships with domestic ownerships with respect to the effects they have on the performance of a firm. Allen and Jun (2005) survey the reforms of enterprise in China and find that state ownership is usually correlated negatively with the performance of a firm.

2.4 Performance of the Chinese Stock Markets

The Chinese stock markets had an impressive growth record during the 1990s. Their performance is notable because of the unique environment in which this growth
took place. According to Wong (2006), during the three decades since 1949, China had adopted a centrally planned economy where all enterprises were either state-owned or collectively owned. All investments were prescribed by the state and were funded by the government. This would take the form of loans from the state-owned banks under a central credit plan of the government.

This framework began to undergo some profound changes during the late 1980s when enterprise reforms were implemented as China started the transition to a market economy (Wong 2006). For example, local governments took the opportunity to experiment with unloading part of their stakes in collectively owned enterprises to private individuals directly in an effort to generate capital, following which over-the-counter trading of these shares started to develop (Wong 2006).

Since 1996 the Chinese economy has entered a state of surplus. This great achievement has reduced rent-seeking opportunities for local officials and managers arbitrating between the economic plan and the market by selling goods from the planned sector to customers at higher market prices. Furthermore, local market niches have become unsustainable, despite the best protectionist efforts of the local cadres (Lin 2008). Widespread privatization of township and village enterprises soon ensued, and state-owned enterprises began to cut losses by discharging workers and experimenting with mergers and other market consolidation options (Lin, 2008; Zhu, 2012). During the period between 1992 and 2003, the Chinese market generated a total of 796.79 billion Yuan (about US$125.81 billion) of equity capital (Wong, 2006). By the end of 2003, the Chinese stock markets had more than 70 million investor accounts and 1,287 listed enterprises (Wong, 2006). By the end of year 2013, the number of companies listed on the Shanghai and Shenzhen Stock Exchanges had increased to 953 and 1,536 respectively.
Table 2.1 Turnover Statistics of the Shanghai Stock Exchange

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Listed Companies</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>953</td>
<td>-1</td>
</tr>
<tr>
<td>2012</td>
<td>954</td>
<td>23</td>
</tr>
<tr>
<td>2011</td>
<td>931</td>
<td>37</td>
</tr>
<tr>
<td>2010</td>
<td>894</td>
<td>24</td>
</tr>
<tr>
<td>2009</td>
<td>870</td>
<td>6</td>
</tr>
<tr>
<td>2008</td>
<td>864</td>
<td>4</td>
</tr>
<tr>
<td>2007</td>
<td>860</td>
<td>18</td>
</tr>
<tr>
<td>2006</td>
<td>842</td>
<td>8</td>
</tr>
<tr>
<td>2005</td>
<td>834</td>
<td></td>
</tr>
</tbody>
</table>

Source: Shanghai Stock Exchange Factbook

Table 2.2 Count of Listed Companies on the Shanghai Stock Exchange

Table 2.3 Turnover Statistics of the Shenzhen Stock Exchange
<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Listed Companies</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>1,536</td>
<td>-4</td>
</tr>
<tr>
<td>2012</td>
<td>1,540</td>
<td>129</td>
</tr>
<tr>
<td>2011</td>
<td>1,411</td>
<td>242</td>
</tr>
<tr>
<td>2010</td>
<td>1,169</td>
<td>339</td>
</tr>
<tr>
<td>2009</td>
<td>830</td>
<td>90</td>
</tr>
<tr>
<td>2008</td>
<td>740</td>
<td>70</td>
</tr>
<tr>
<td>2007</td>
<td>670</td>
<td>91</td>
</tr>
<tr>
<td>2006</td>
<td>579</td>
<td>35</td>
</tr>
<tr>
<td>2005</td>
<td>544</td>
<td></td>
</tr>
</tbody>
</table>

Source: Shenzhen Stock Exchange Factbook

Table 2.4 Count of Listed Companies on the Shenzhen Stock Exchange

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Annual Volume (Shanghai)</th>
<th>Change (in Millions)</th>
<th>Total Annual Volume (Shenzhen)</th>
<th>Yearly Change (in Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>2,643,717</td>
<td>768,699</td>
<td>2,149,803</td>
<td>764,009</td>
</tr>
<tr>
<td>2012</td>
<td>1,875,019</td>
<td>(214,015)</td>
<td>1,385,794</td>
<td>117,232</td>
</tr>
<tr>
<td>2011</td>
<td>2,089,034</td>
<td>(461,791)</td>
<td>1,268,562</td>
<td>(349,431)</td>
</tr>
<tr>
<td>2010</td>
<td>2,550,825</td>
<td>(775,822)</td>
<td>1,617,993</td>
<td>(110,485)</td>
</tr>
<tr>
<td>2009</td>
<td>3,326,647</td>
<td>1,712,523</td>
<td>1,728,478</td>
<td>949,461</td>
</tr>
<tr>
<td>2008</td>
<td>1,614,124</td>
<td>(776,822)</td>
<td>779,018</td>
<td>(428,820)</td>
</tr>
<tr>
<td>2007</td>
<td>2,390,946</td>
<td>1,382,003</td>
<td>1,207,838</td>
<td>629,013</td>
</tr>
<tr>
<td>2006</td>
<td>1,008,943</td>
<td>612,878</td>
<td>578,825</td>
<td>317,034</td>
</tr>
<tr>
<td>2005</td>
<td>396,065</td>
<td></td>
<td>261,790</td>
<td></td>
</tr>
</tbody>
</table>

Table 2.5 Turnover Summary of the Shanghai and Shenzhen Stock Exchanges

**Sector Distribution and Number of Companies**

<table>
<thead>
<tr>
<th>Industry</th>
<th>Number of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Shanghai</td>
</tr>
<tr>
<td>Agriculture</td>
<td></td>
</tr>
<tr>
<td>Mining</td>
<td></td>
</tr>
<tr>
<td>Sector</td>
<td>Shanghai</td>
</tr>
<tr>
<td>------------------------------------</td>
<td>----------</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1081</td>
</tr>
<tr>
<td>Utilities</td>
<td>32</td>
</tr>
<tr>
<td>Construction</td>
<td>32</td>
</tr>
<tr>
<td>Wholesale and Retail</td>
<td>62</td>
</tr>
<tr>
<td>Transportation</td>
<td>25</td>
</tr>
<tr>
<td>Accommodation and Catering</td>
<td>10</td>
</tr>
<tr>
<td>Information Technology</td>
<td>98</td>
</tr>
<tr>
<td>Finance</td>
<td>11</td>
</tr>
<tr>
<td>Real Estate</td>
<td>68</td>
</tr>
<tr>
<td>Business Support</td>
<td>13</td>
</tr>
<tr>
<td>Research &amp; Development</td>
<td>11</td>
</tr>
<tr>
<td>Environmental Protection</td>
<td>19</td>
</tr>
<tr>
<td>Education</td>
<td>NA</td>
</tr>
<tr>
<td>Public Health</td>
<td>2</td>
</tr>
<tr>
<td>Media, Culture, Sports &amp; Entertainment</td>
<td>13</td>
</tr>
<tr>
<td>Conglomerates</td>
<td>7</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>1536</strong></td>
</tr>
</tbody>
</table>

Table 2.6 Sector Distribution and Number of Listed Companies on the Shanghai and Shenzhen Stock Exchanges

Since the economic reform in 1978, the Chinese economy had consistently recorded tremendous growth for two decades. Much of the economic growth was contributed by the rural and township enterprises and private enterprises. This posed a threat to the state-owned enterprises which were less efficient. Restructuring the State owned enterprises became a pressing need (Qi et al, 1999). In comparison to the privatization approach adopted in the Eastern European countries and Russia, China had adopted another approach (Qi et al, 1999). This approach posits that if competitive markets are created for products and production factors, state owned enterprises will be able to be transformed successfully from loss making cost centers into profitable, return oriented centers regardless of changes in ownership structure (Qi et al, 1999). The results, however, mixed as while the economy grew at high rates it nevertheless failed to improve the performance of state-owned enterprises, as reflected by the increase in the percentage of the state-owned enterprises that were running in red (Li, 2008).
As a result, systematic reform of ownership has become the task for the restructuring of state-owned enterprises. Some loss making medium or small sized state-owned enterprises were transformed into shareholding companies with limited liabilities. Selected state-owned enterprises were allowed to be listed on the Shanghai Stock Exchange and the Shenzhen Stock Exchange. There was a belief that the transformation could save state-owned enterprises from the interference of government in their routine operations, help them raise new capital, clarify their property rights, and make management more responsible for the outcomes of their decisions. The state will also benefit from better corporate performance of these state-owned enterprises (Qi et al. 1999).

Li (2008) argues that the performance of state-owned enterprises cannot be enhanced solely by transforming these enterprises into shareholding companies. Due to the separation of control and ownership, severe agency problems arise. These problems will continue to exist in the transformed state-owned companies. Qi et al (2008) argue that the role of the state and its representatives is not always very clear and may not be solely for maximization of profits. For instance, the state may require government owned enterprises to keep some redundant workers on the payroll to maintain social stability, at the expense of company profits. Due to the free-rider phenomenon the individual minority shareholders are not much motivated to closely monitor management (Qi et al, 2000). There is little incentive for the state to monitor and check management whose interests conflict with that of the state. There is a possibility that the transformed state-owned enterprises may see unstable performance due to their ownership structure (Li, 2008).
Across the board, the Chinese experiment with corporatization has exceeded even the liberal model recommended by the World Bank (Cao, 2000). The Chinese State Council promulgated regulatory guidance in May 1992 that classifies the shares of an enterprise into three different kinds. Wong (2006) gives a general description of the properties of these kinds of shares as:

1. Legal and state person shares

   These shares are owned either indirectly or directly by the state and cannot be freely traded on the stock exchanges. However, with the approval of the administration, they can be transferred to other legal persons.

2. A-shares

   These are shares that are denominated in Renminbi. A-shares can only be owned by and sold to domestic private individuals or entities. They can be freely traded on the stock exchanges; and

3. B-shares

   These are shares denominated in Hong Kong Dollars or US Dollars. They can be owned by and traded among foreign investors on the stock exchanges. Since 2001, domestic investors can also trade in B-shares.

The new regulation effectively codifies an interesting aspect of China’s stock market in which there are three distinct markets for the stocks of a listed enterprise: (a)
one-way transfer market for state-owned shares, (b) A-shares market for domestic private shareholders, and (c) the B-shares market for foreign investors (Wong 2006). Qi et al. (2000) report that equity ownership of listed companies in China actually possesses five classes: (1) state owned shares, (2) tradable A-shares, (3) shares of employees, (4) legal person shares, and (5) shares that are available only for the foreign investors.

Laws and regulations were also enacted for enterprises to “corporatize” into entities established on the basis of a stock ownership system. At the national level, the State Commission for Restructuring the Economic System ("SCRES") and other relevant government departments jointly issued the Share Enterprise Trial Measures (the Measures) on 15 May 1992. Pursuant to the Measures, the SCRES issued “Opinion on Standards for Companies Limited by Shares (Opinion)” that sets out guidelines for establishing stock companies. It is not clear why the opinion is called an “opinion” rather than “regulations”, and whether it should be given less weight than other national regulations. At the local level, Shanghai and Shenzhen each enacted their own separate guidelines for the establishment of stock companies (Wang, 2000).

Although there is a lack of relevant research in this area, a seminal study of the role of institutional shareholders in the performance of publicly listed Chinese companies by Wang and Xu (1997) finds that the effect of ownership concentration is greater for companies that are dominated by legal persons than those dominated by the state.
2.5 Corporate Governance Trend and Framework

The trend of corporate governance is frequently discussed in various literatures. Some of researches have supported the convergence theory of corporate governance. They are of the opinion that competition and globalization drives corporate governance towards a standardized rule that applies to every country around the world. Hermalin (2005) formulates a model that explains and predicts the corporate governance’s trend. He also finds that greater diligence of the board, more external candidates for the position of chief executive officer (CEO), short term tenures for CEOs, less consumption by the CEOs and greater compensation for CEO is a trend for corporate governance.

Khanna et al. (2006) conduct a cross country analysis and are of the opinion that countries which are economically empowered have the same modes for globalization and corporate governance. Similarly, Gillan (2006) builds a framework for corporate governance, which includes internal governance like board members and management, and external sources of governance such as capital and law markets. Most authors are of the opinion that a wider perspective on corporate governance will be a future trend.

2.5.1 Structure of Board of Directors

Most literature on board structure tends to focus on the size of the board, its independence, composition and activities. Linck et al. (2008) carry out a research using a sample of about 7,000 organizations in the United States for the period from 1990 to 2004 to investigate the determinants of the corporate board. They define the size of the
board, its independence and leadership in the board as determinants of the board structure. They find that the size of the board in large organizations reduced in the year 1990, whereas the size of the board in small firms has been comparatively flat during the same period.

In a similar manner Boone, Field, Karpoff, and Raheja (2007) conduct a study in which they suggest that the environment of the economy and the management team have a significant impact on the size of the board and its composition. They find that the size of the board and its independence increases when companies become mature and grow over time. They also highlight that the composition of the board results from the conciliation between the external directors and CEO.

The study of board size, frequency of board meeting, board composition and the relationship with the performance of a company has been broadly discussed in the literature review of other studies. For example, Yermack (1996) conducts study on 452 large corporations of the United States for the period from 1984 to 1991 and finds that smaller board size is always effective. Vafeas (1999) incorporates 307 firms of United States for the period from 1990 to 1994 for examining the frequency of the board meeting and company’s performance. He identifies a reverse association between the frequency of board meetings and firm value.

Hermalin and Weisbach (1991) study the effects that composition and incentives of the board have on firm performance for 142 firms listed on the New York Stock Exchange for the period between 1971 and 1983. They find that there is no association between the composition of a board and the performance of a firm. Krivogorsky (2008) explores the board of director’s composition by using 87 firms in Europe for the period
from 2000 to 2001 and finds that a positive association exists between the profitability of a firm and the percentage of its independent directors.

2.5.2 CEO Role

The tenure of the CEO and the impact it has on the profitability of a firm has been frequently discussed in various literature. Hermalin and Weisbach (1991) carry out a study in which they conduct regression analysis on the tenure of CEO and the profitability of a firm. In their research, they find that the tenure of the CEO does not have an effect on the profitability of a firm if the tenure of the CEO is short. Another similar study is conducted by Brookman and Thistle (2009) using data for the period from 1993 to 2001 and examines the value of a firm and the tenure of CEO. They also identify that that approximately 82 percent of the CEOs have tenure of less than thirteen years. They find that the tenure of the CEO of a firm increases with an increase in firm performance but decreases as the degree of monitoring of the board increases.

Henderson, Miller, and Hambrick (2006) explore the performance of a firm and the tenure of the CEO by focusing on the computer and food industry. In their research, they discover that in the stable food industry, the performance of a firm increases with the tenure of the CEO. On the other hand, in a dynamic sector such as the computer industry, the performance of the CEOs is the best in the initial years while performance of the firm tends to decline slowly in the subsequent years.

Various studies have investigated the association between compensation of executive and the organization performance or its corporate governance. Core et al.
(1999) carry out a research and suggest that CEOs will focus on greater compensation, when the corporate governance of a firm is weak. Another research conducted by Basu et al. (2007) identifies that compensation of the executives is greater in companies that have weaker corporate governance.

Kato and Long (2006) study the Chinese companies listed on the Shenzhen and Shanghai Stock Exchanges for the period from 1998 to 2002, and find that the performance of firms in China is highly dependent on and related to the compensation provided to the executives. They also find that the association between executive compensation and CEO performance in government and state-owned enterprises is relatively weaker than in firms that have less control by the government or the state.

2.5.3 Corporate Governance Index

Various studies have been conducted on corporate governance index and value of a firm. Ruan and Tian (2011) construct a corporate governance index by using twenty four provisions of governance for approximately 1,500 firms in the United State for the 90s and find that the value of a company has a positive relationship with the rights of its shareholders. Wong (2006) utilizes 6 provisions of corporate governance for creating an index of entrenchment for approximately 1,400 to 1,800 organizations for the period from 1990 to 2003 and concludes that organizations having higher levels of entrenchment index tend to have negative performance.

Wong (2006) develops a Corporate Governance Index to determine the quality of corporate governance practices in Chinese organizations. He also examines the
relationship between market value of organizations and the quality of corporate governance at Chinese firms and discovers that no association exists between the performance of a firm and the quality of corporate governance. La Porta and Florencio (2002) examine the relationship between the performance of a firm and the quality of corporate governance and find that stock ownership by the board of directors, better practices of corporate governance and separation of the CEO from chairmanship all have a positive association with firm performance.

Sun and Wilson (2003) study the effects of the 2002 policies of governance under the Sarbanes-Oxley Act on the value of a firm and find that firms that have fewer complaints earn better returns in comparison to firms that have more complaints. Wang and Lixin (2005) study the effect of corporate governance practice on market value of organization in India. They discover that there is a four percent increase in the stock prices of the larger firms and seven percent increase among smaller public firms.

2.5.4 International Characteristics

La Porta and Florencio (1997) carry out a survey on corporate governance that focuses on investors’ legal protection in the context of corporate governance. They suggest that good practice of corporate governance must be combined with sufficient legal protection for investors. Additionally they study the ownership of listed firms in the twenty seven wealthiest economies and find that firms in the wealthy economies are generally controlled by either the state or families (Wang and Xiao, 2006).
La Porta and Florencio (2002) conduct a research on minority shareholders legal protection by examining the rules and their enforcement in forty nine countries. They find that countries adopting common laws have strong legal protection for investors. Sun and Wilson (2003) conduct a research that includes more than 110,000 people who are employed at the subsidiaries of IBM in almost forty countries. He develops four dimensions to examine the cultures of a number of countries and concludes that culture has an effect on the behavior of a region or a nation over time.

### 2.6 Characteristics of CEO and Performance of Firms

There are a number of research studies that have been conducted on the responsibilities of the chief executive officer (CEO) towards the performance of organizations. For listed firms, the responsibility of the CEO is regarded as important as he/she is involved in strategic decision making that include collection, processing of information, development of strategies and directing of the implementation throughout the organizations (Lefebvre, 1992; Lefebvre, 1997; Thong, 1999; Wincent and Westerberg, 2005; Arendt et al, 2005). A number of authors agree that the CEO plays an important function on organizations performance (Lefebvre, 1992; Thong and Yap, 1995; Lefebvre, 1997).

CEO is being looked upon as the final individual to make major decisions which are important to the vision and the strategic direction of the organization (Calori et al, 1994; Alice et al, 2000). During the day to day planning, reduction of cost, innovation and strategic direction of companies, CEOs act as a mechanism through which their own cognitive conduct and values impacts the manner they interpret and perceive data (Daellenbach et al, 1999). This idea is supported by Hambrick and Mason (1984) who
argue that the primary determinant of the cognitive behavior, bias and value of the CEO include educational background, age and work experience. In spite of a general agreement that CEOs influence a firm’s performance in some specific ways due to their heterogeneous talents and skills for example (Gabaix et al, 2008; Bennedsen et al, 2008), theorist and scholars remain divided and have provided little evidence to support which managerial/behavioral characteristics, educational background or CEO attributes are essential for firm performance. This leaves us with the question of which educational background of the CEO really matters for enhancing firm performance given the challenges in today’s business world. While this topic is not completely new in the area of research, certain aspects make this study different.

In studying the association between CEO personality and organization performance, such factors as CEO age, firm size, ROA, firm leverage are considered continuous variables. CEO educations, gender, appointment type, CEO being one of top shareholders, are discrete variables. Bhagat et al, (2010) investigate the influence of CEO educational background and CEO turnover on an organization performance. Bhagat et al, (2010) use information on CEO age, tenure, ownership and educational information from a sample of 14596 CEO years, based on 1,500 U.S large firms, between 1992 and 2007. Bhagat et al, (2010) research findings reveal that CEO educational background has little influence on organization performance. However, the findings also indicate that CEO educational level has an impact on CEO selection but has little influence on the long run profitability of the firm.
2.7 CEO Compensation and Performance of Firms in China

Since the main purpose of China’s economic reform is to facilitate the transformation of state-owned enterprises into modern organization that can competitively compete in the international market place (Ma et al, 2014), the success of the stock markets in China is a good measure of the success of the transformation of the state-owned enterprises (Lu and Shi, 2012). Corporate governance is meant to guide the manner in which financial suppliers of organizations assure themselves of acquiring earnings on their investment (Chen, 2005).

Based on disclosed information, Delios and Wu (2005) discover that listed firms that maintain good corporate governance practice earn higher valuation in the stock markets and the premiums connected with good corporate governance are significantly higher as compared to other developing markets.

On the contrary, Bai and Qiao (2004) suggest that the restructuring of state-owned businesses in China has not completely fulfilled the task of facilitating corporate governance to achieve better performance. Based on the interviews conducted with government officials, public accountants, corporate lawyers, stock exchange regulators, and officials at non-listed and listed firms they conclude that corporate governance is not properly practiced at Chinese listed firms as reflected by too much power being in the hands of the CEO, management control by insiders, inadequate transparency and disclosure, inadequate safeguards for outsiders, and weak managerial incentives (Kato and Long, 2005).
Lin (2008) argues that the main cause of poor practices of corporate governance in Chinese organizations listed in stock exchange market is due to the large proportion of shares being owned by the government and that gives the government dominating management and controls the firms and their management. This concept is different from the view that the steady advance of the Chinese government for changing state-owned enterprises will be a success in the long-run without going through the process of privatization (Ruan and Tian, 2011). Multiple waves of state-owned enterprises reforms in 1985 and 1992 allow the remuneration budget of SOEs to be tied with their overall economic performance. Within the remuneration budget, these SOEs are also allowed to set their internal remuneration scheme for their employees (Kato and Long, 2005). The guiding principle is to make the remuneration package result-oriented.

One of the main remuneration methods arising from the reforms is a combination of fixed salary and additional benefits payments for the employees. However, two limitations have narrowed the scope for executive compensation in reforms (Bai and Qiao, 2004). The remuneration plans for state-owned enterprises must be approved in advance by the Ministry of Labor to prevent state-owned enterprises from paying salary taxes. Additionally, in state-owned enterprises management generally lack a fully independent human resource function of hiring and firing employees. Remuneration is mostly egalitarian compensation that lacks real incentive. In 1992 only after the implementation of an ‘annual salary system’ is it possible for the substantive executive reimbursement system to take place. Since then, Sichuan, Shenzhen, Liaoning, Henan and Beijing initiated their own pilot programs, following which a national pilot program was applied throughout the country in 100 large state-owned enterprises. The pilot experiment was a success with the annual salary system becoming an important part of the executive compensation in China since 1997 (Chen, 2005).
The remuneration for CEOs under the ‘annual salary system’ comprises a basic compensation and a variable compensation. The basic compensation is disbursed to the executives every month, whereas the risk-based compensation is disbursed at the end of every year. The variable part is determined in a traditional ‘annual remuneration system’ by the following formula (Delios et al, 2005):

\[
\text{Risk remuneration} = \text{previous year risk remuneration} + \text{basic remuneration} \times \sum \text{(performance measures} \times \text{weights)}, \text{ where the performance measures are general accounting measures for net profit and return-on-equity. For state-owned enterprises, another pecuniary measure commonly used is the growth rate of the value of the asset owned by the government. Some state-owned enterprises also included non-pecuniary measures such as production safety and service level (Allen and Qian, 2005).}
\]

2.8 S&P 500 Effects

The well-documented S&P 500 effect basically says that stocks that are included in the S&P 500 index will garner a premium. One branch of the literature brings capital markets-related explanations to this effect. Liu and Pei (2005) find that institutional holdings of a firm increase (decrease) following its inclusion to (deletion from) the S&P 500 index. Abnormal returns on stocks included in or deleted from the S&P 500 index are due to institutional trading.

Wang and Yu (1999) find that S&P 500 trading strategies cause a price pressure on the index stocks, and this price pressure causes the betas of index firms to increase in comparison to non-index firms. Sun and Tong (2003) opine that indexing causes the demand curve for index stocks to be downward-sloping, and as a result causes the q-
ratios of S&P 500 index firms to increase with the growth of indexing. La Porta and Florencio (2002) find investor awareness to be the primary factor in explaining the S&P 500 effect. Chen (2005) suggests that there is a lasting increase in share price of companies added to the S&P 500 index but there is no lasting decrease in the price of firms deleted from the index. They all take the view that investor awareness partly explains the asymmetric response of price to addition to and deletion from the index.

Bai and Qiao (2004) discover that stocks that are added to the index gain sustained liquidity due primarily to a reduction in the direct transaction cost and a smaller reduction in asymmetric information. The liquidity of deleted stocks is found to decrease in the three months after deletion. This can potentially make monitoring easier and the firm management more accountable. Because addition to the index is exogenous to the firm and also is a significant event, one can look into various aspects of corporate finance around this event (Lin, 2008).

2.9 Institutional Investors and Corporate Governance

If institutional investors are active, then they must be having an influence on a firm's decision making process. This can happen in two ways. Firstly, activist institutions may engage in the decision making process through informal ways such as making phone calls to or asking for meeting with top management or making public comments about management decisions in the form of press releases (Delios et al, 2005). Secondly, institutions may be capable of changing the composition and structure of the top management and board, either directly through their voting power or indirectly by putting pressure on the board of directors and top management. Cao (2000) finds that not all institutional investors are careful in choosing their investments from among
firms that practice good corporate governance. He also finds that companies having institutional ownership of higher level are sensitive to the rights of shareholders and are seen to have improvements in shareholder rights. He discovers that the legal type of institutions and block holdings are poor proxies for governance sensitivity and hence activism. Ruan et al (2011) study the activism efforts of a UK fund and find that the fund follows its activist policies predominantly through private interventions that are unobservable by the public.

Bai and Qiao (2004) find that the risk of CEO seeking unreasonable compensation increases with firm sizes, institutional ownership, stock return volatility as well as Tobin's Q. Furthermore, this CEO compensation risk and institutional ownership are endogenously and positively related. Huge increases in institutional ownership are positively correlated with increases in CEO compensation risk. Institutional selling does not increase CEO compensation risk. Allen and Qian (2005) find that institutions doing momentum trading are better-informed or are more prudent to sell to other institutional investors and individual investors. Chen (2005) finds that corporate fraud in Australia decreases with board independence and institutional ownership, and increases with CEO and chairmanship duality.

McCahery et al (2010) conduct a survey among institutional investors and find that corporate governance is important for them, and that they are willing to engage in activism, primarily by voting in absenteeism. The authors also find that institutional investors' investment decisions are correlated with their preferences, earnings management, and governance.
Delios et al (2005) apply discretionary accruals in the measurement of revenues for management and find that where a firm has large institutional shareholders, its management is discouraged from earnings manipulation. Allen and Qian (2005) predict that CFOs' primary responsibility of financial reporting makes their role in earnings manipulation stronger than CEOs. They find that discretionary accruals and the likelihood of beating benchmarks and earnings restatements are affected more by CFOs' equity incentives than by the equity incentives of CEOs. Wong (2006) finds that institutional ownership, board independence and institutional representation on the board reduce discretionary accruals.

Chen (2005) highlights the performance of private equity placements and earnings manipulation and suggests that sophisticated investors may be failing to detect earnings manipulation that aim at boosting reported performance prior to private equity issues. Ruan et al (2011) find that corporate governance mechanisms and earnings manipulations are endogenously determined. Wong (2006) examines the role of institutional ownership by dividing firms into two samples - firms that do engage and firms that do not engage in earnings manipulation. He finds that long-term institutions restrain earnings manipulation at firms that manipulate their earnings to meet or beat targets. He also discovers that transient institutional ownership is associated with earnings manipulation only in firms that do engage in earnings manipulation. He concludes that transient institutional ownership-related myopia may not be as serious as documented in the literature.

Allen and Jun (2005) find that firms followed by more analysts are having less chances of manipulating earnings upward and most likely to guide analyst to conservative forecasts. They also find that organizations with higher transient institutional ownership have high chances to manipulate earnings upward whereas
companies with higher dedicated institutional ownership have less chance to manipulate earnings upward. Chen (2005) discovers that a high percentage of institutional ownership in a firm reduces the likelihood of a cut in research and development expenditure to achieve earnings goals (Swimberghe and Wang, 2008) whereas a high percentage of ownership by institutions with high portfolio turnover and momentum trading increases such likelihood.

Lin (2008) uses UK data for analysis and finds that more independent board members work better in restraining manipulation of research and development expenditures. Allen and Jun (2005) find that there is income-increasing earnings manipulation prior to bond issues which results in a lower debt cost for firms engaging in earnings manipulation and that bondholders, the majority of which are institutional investors, fail to detect earnings manipulation when they have price debt issues.

2.10 Corporate Governance and Ownership Structure

According to conventional finance paradigm, in public corporations where ownership is widely distributed between atomistic investors there is a higher likelihood of agency problems between shareholders and managers. In many countries, this paradigm may not be applicable especially in countries where business groups, government or families control most of the firms (Delios and Wu, 2005). Even in the United States, the majority of companies are still governed by a controlling shareholder (Chen, 2005). A new type of conflict of interest arises between the minority shareholders and the dominant shareholders due to the concentrated ownership structure. This conflict of interest prompts diversion of company asset to the dominant shareholders, thus reducing the overall value of shareholders (Bai and Qiao, 2004).
When the voting rights of the dominant shareholders go beyond their proportional entitlements to cash-flows, the incentive for asset diversion increases as private consumption costs of the dominant shareholders are proportionally less than those of the minority shareholders (Wong, 2006). The conflicts between disproportional cash-flow entitlements and voting rights arise under three different situations: (1) use of multiple-class shares, (2) indirect ownership through pyramidal structures and (3) aggregation of voting rights through business groups. Firms on top of a pyramidal structure are bestowed with disproportionate voting rights over firms that are at the base of the pyramid (Ruan et al, 2011).

Under the pecking order theory of Myers and Majluf (1984) the disputes regarding self-control are manifested because issuing non-voting stocks and voting stocks are presented as a last resort when external financing cost becomes very expensive. Also, the pecking order theory is different from the argument of Ruan et al. (2011) regarding the bank centered financial system, in which companies mainly depend on debt finance and very often issue equity to raise funds.

In markets where rights of minority shareholders are protected, the dominant shareholders and some of their close collaborators might take management into their hands. It is assumed that the behavior of the managers is in the interest of dominant shareholder (Wong, 2006) and the block shareholders are active in monitoring instead of being passive investors (Bai and Qiao, 2004). According to Allen and Qian (2005), such a framework raises questions on managerial roles on whether they can make decisions independently. Managers in any case will have to coordinate with the dominant shareholders, even if they do not belong to the business group of the dominant shareholder.
Chapter 3: RESEARCH METHODOLOGY

3.1 Introduction

A number of empirical evidences have shown that Chinese firms possess different attributes in comparison to firms in other economies. The various factors that may have an impact on a firm’s performance have been discussed in the literature review. These factors include the major shareholder groups, ownership structure and ownership structure. While the CEO plays a pivotal role in firms of other developed economies, the significance of the CEO in Chinese firms, especially SOEs, has only become noticeable until recently. Studies in this area are still relatively limited. In this research study, the impact of the various factors including on the performance of Chinese firms will be investigated.

In this section, the focus is on the method with which this research study is conducted. It covers the development of the hypothesis, determination of the research method, data collection and the analytical tools used.

3.2 Research Method

This research study has adopted a secondary quantitative research approach, and will use regression analysis to study public data on companies listed on the Shanghai and Shenzhen Stock Exchanges. The data used in this research study cover the period from 2010 to 2013. This period is chosen because China started a reform on stock split
in 2006 to allow the non-tradable “A” shares to be converted into tradable shares. This process took some time to complete. In addition, 2008 saw the global financial crisis the effect of which extended to 2009 before the market started to normalize. While it would be good to choose data from the most recent period, the data from the years of 2006-2008 may be distorted. 2010-2013 is the most recent period when the market returned to normal and where data are practically available.

3.3 Research Design

Choosing a design for the research is the major concern for the researcher (Easterby and Thorpe, 2008). The outline for the survey is an arrangement of how the research will be conducted (Davies, 2007). Research design is a framework or a plan indicating the approaches and procedures for gathering and examining the data (Creswell, 2005). It has a focus on research and provides guidance to the researcher, in a bid to provide solutions to the issue at hand in the research along with managing the potential sources of mistakes in the research (Easterby and Thorpe, 2008). The research design also determines the information needed and states the sampling method and the data analysis procedures (Davies, 2007). This research has adopted a descriptive research approach.

3.3.1 Descriptive Research

Creswell (2005) recognizes that, a descriptive research approach entails giving vivid descriptions of the details of the existing variables used in the study. The use of this design entails a little bit historical information of the issues under study. It differs
with other forms of research approaches since it is has proper frameworks that describe the situation (Easterby and Thorpe, 2008). The outcomes of the descriptive research are to (i) understand the characteristics of a group in a given situation (ii) think systematically about aspects in a given situation, and (iii) offer ideas for further research (Denzin and Lincoln, 2003). Therefore, descriptive research ignores the details that relate to the factors that lead to the findings. However it concentrates on getting solutions on the issues under study (Creswell, 2009). Descriptive research uses secondary data, expert panels, case studies and surveys as the source of data collection (Creswell, 2005). Descriptive research obtains accurate information about a given topic. It usually starts with a hypothesis which it seeks to accept or reject. It is used when studying a situation that is clear, information needs are sufficiently precise, and the problems and variables are identified. It is often preceded by an exploratory research that helps to formulate the hypothesis and better understand the parameters that are to be studied (Creswell, 2005). While exploratory research provides qualitative results and only from a small number of respondents, descriptive research can perform quantitative analysis on representative samples of the population studied. There are three main methods of data collection in descriptive research: mail, telephone and face-to-face. The choice depends upon certain factors such as objectives and available resources. Thus, the accuracy and extent of data to be collected, the time and effort required, the costs associated with each mode of collection, as well as their own administrative requirements are all factors to be considered (Creswell, 2005). Regardless of the tool used, the researcher wishes to minimize biases and sources of error in data collection. Four main sources of error may occur during a descriptive research. There are refusals to answer, sampling errors, and incorrect answers to interviewer or interviewer bias (Creswell, 2009). The researcher must always keep in mind the possibilities of bias and try to minimize it.
Refusal to answer certain elements of the sample can be a source of error. In fact, the possibility that the statistics collected provide a biased picture of reality is proportional to the number of people who refuse to answer a questionnaire. Not knowing what these people believe, it is difficult to ascertain if the survey results are accurate. While the phenomenon of non-respondents in a survey cannot be eliminated, their number may be reduced to a minimum by designing adequate measurement tools (Creswell, 2009).

The third major source of error in a descriptive research is inaccurate responses. It may simply be due to ignorance of the respondent who may give an answer at random for fear of admitting ignorance or prefer to respond following the apparent consensus on a particular topic. Facts may be forgotten if the data collection is done too long after the facts occurred analyzed. It may also result in individual attitudes where the respondent intentionally skews their answers based on certain personal factors.

Finally, the fourth source of error lies in the interview itself. From the attitude, gestures and the way the interviewer asks questions, the interviewer may unconsciously influence the respondent. Professional training of the interviewers can minimize this potential source of bias (Easterby and Thorpe, 2008).

3.4 Various Research Paradigms

A paradigm is a system of basic beliefs (Denzin and Lincoln, 2003). It represents the view of the world that defines the nature of its holder and the individuals in it, and ranges between the relationships that can be possible around the globe and in
its parts (Davies, 2007). Creswell (2009) defines a paradigm, as a complete framework of concepts in which the researcher may work, and it may either be implicit or explicit. A paradigm is considered to be a basic system of worldwide beliefs that provides guidance to researchers and helps them deal with the first or the ultimate principles (Creswell, 2005). A paradigm is a structure of values, ideas, techniques and directions that are used as a basis upon which several scholarly works thrives on as their fundamental argument (Creswell, 2005).

The usage of a paradigm is common within scientific studies and this is also applicable on business surveys. The choice of an effective paradigm has effects on the final findings of the survey. However this only works if the role of the paradigm is clearly outlined (Cooper and Schindler, 2006).

Ontological, epistemological and methodological assumptions form the basis of a paradigm. The culmination of these philosophical aspects offers a formidable structure for the survey to determine the relevant methodology and the characteristic of the researcher’s involvement.

Ontology refers to the basic paradigm of beliefs which are concerned with the characteristic of reality (Creswell, 2005). In the initial stages of the research, the focus of the research should be towards obtaining solutions to the ontological concern in the study. In the research, the concern would be on the desire to get explanations on the social environment that surrounds human beings.
Epistemology concentrates on the existing connection between the study and the researcher (Easterby and Thorpe, 2008). It also has a focus on the relationship between the knowable and the knower (Creswell, 2009).

Methodology is descriptions that reflect on the processes that contribute to the development of a particular content within the study. It is not similar to methods, which refer to the approaches of gathering data (McMurray, 2007). Research methodology relies on the ontological and epistemological frameworks of the paradigm.

3.5 Research Philosophy

Despite its strengths, the positivist exhibits two disadvantages in this research. To begin with, the quantitative aspect of the study focuses on the confirmation of a theory (Creswell, 2005). This contradicts the perception whereby there is development and discovery of the hypothesis (Cooper and Schindler, 2006).

Quantitative method of research requires a controlled environment (Denzin and Lincoln, 2003) which is not possible in many cases as there are several factors which could influence the buying behaviors and decisions. In addition, an induced setting leads to results which do not reflect the reality devoid of rigor and unreliable findings (Creswell, 2009).

Constructivism suggests that individual perceptions about the world tend to be subjective since everyone has his personal view in relation to a particular aspect. In this
research, the epistemology indicates that the participants are in coordination and they influence the findings in the research. Therefore, it is related to the strategic decisions that are taken by the senior management and about the implementation of those decisions rather than with the emotions and thoughts of humans (Davies, 2007).

3.6 The Quantitative Research Method

The positivist or quantitative paradigm is characterized by the usage of theoretical propositions that are to be tested empirically in order to determine whether the propositions are actually true (Denzin and Lincoln, 2003). It is interested in measuring the relationship between variables (Easterby and Thorpe, 2008). Thus, the findings are not subjected to the interpretation of the researcher. As it concentrates on determining the underlying relationship between variables it is suitable for theory testing (Denzin and Lincoln, 2003). It requires the collection of large amounts of quantifiable data to meet the evaluation criteria of validity and reliability for statistical analysis (Davies, 2007). The findings are deductive and generalize for time and place. The only weakness is that it treats the people mechanically by putting greater emphasis on the numbers. The researcher becomes a scientist who is disinterested in searching for the general cause and effect relationship that is derived on a logical basis from the casual law (Creswell, 2009). Thus, the researcher is completely away from the process and is not in a position to either understand or observe the use of judgment for the evaluation of behavior (Creswell, 2005).
3.7 Secondary Method of Research

Secondary data are easily accessible (Cooper and Schindler, 2006) and are likely to be of greater quality compared to the collection of primary data (Easterby and Thorpe, 2008). The sources are written documents, and published information such as books, journals, government publications, periodicals and newspapers. Such data can be accessed through perusal of the recorder, published information or internet (Denzin and Lincoln, 2003).

Acquiring secondary data saves time and cost but it has the drawback of being obsolete or not meeting the specific needs of a particular situation (Easterby and Thorpe, 2008). A research requires secondary research methods to ensure that there is more information about the study in question. This is because it creates diversity during the research (Davies, 2007). Sources of secondary data range from industrial players, products to the existing customer base. Secondary data offers a more diversified approach to the subject under study. During gathering of secondary information the study can use both internal and external sources. Internal sources are those that are obtained by the researcher when the research is in progress. Conversely, external data is that which is acquired from sources that are not active participants in the research (Creswell, 2005).

3.8 Effects of the Secondary Research Method

One of the advantages associated with this method is that it saves time. This is because secondary resources are readily available hence the researcher is in a position to
get information easily without going through technicalities such identifying a cooperating respondent. Secondly, it is also cheap considering that a researcher can access them in nearby resources such as websites and magazines. Thirdly, most of the information that is gained from secondary sources is always related to the study. This is because the researcher uses customized links to get the information.

However, the secondary source of information has some disadvantages. To begin with, some of them tend to provide scanty information since they concentrate on a single topic that is forms a fraction of the research. Secondly, some of the secondary resources give unreliable information. Most organizations including public institutions tend to provide skewed information that acts as a mere tool of public relations (Creswell, 2005). Through this a researcher may use information that does not satisfy the expected standards.

### 3.9 Justification for the Research Method

Inductive and deductive are closely related when describing research activities (Creswell, 2009). This is because both paradigms have merits and demerits. One of the best strategies has been the use of both quantitative and qualitative.

The scholarly research has proved that the use of these approaches is becoming popular (Easterby and Thorpe, 2008). Since the two methods complement each other, the qualitative and quantitative approaches are combined for the purpose of developing a hypothesis and validating the premises (Davies, 2007).
Both research methods are not mutually exclusive and can be used in a complementary manner. They can also be applied in various phases of the research words (Cooper and Schindler, 2006). Quantitative data emerge from the bigger samples that are an important aspect of the research, and are better suited for generalizing the findings of the qualitative method of research (Creswell, 2005).

Each approach has positive attributes and a combination of inductive and deductive approaches will produce better results and scope. This method permits an investigation of the underlying issues with the adoption of the alternatives that are creative enough to carry out the research study (Easterby and Thorpe, 2008).

Usually, business research is a mixture of research methods because it permits a complementary and a broader perspective on the research topic (Cooper and Schindler, 2006). Creswell (2005) says that methods should be mixed in a way that they have complementary strengths and non-overlapping weaknesses. It is seen that a flaw of one method is usually the strength of another and by the combination of various research methods observers can achieve the best of both the methods while overcoming their exclusive deficiencies (Davies, 2007).

3.10 Research Questions and Hypotheses

As articulated in the literature review, a lot of similar studies have been conducted by various academics previously but so far there does not seem to have a conclusive
argument that explains the results of the various studies some of which produce mixing or conflicting findings. One reason could be that as those studies were done at different times while the Chinese government policy regarding marketization of the economy and corporatization of the state-owned enterprises was still evolving. Although more new policies that are aimed to reform and further improve the Chinese capital markets are still forthcoming, it is of academic interest to investigate if, after the non-tradable “A” shares were fully released to become freely tradable, these factors have a similar or different impact on Chinese listed companies under a new regulatory corporate and regulatory framework that are in general in line with those of the developed economies. In addition, even the SOEs are now gearing towards retaining professionals, albeit most of them are still incumbent government officials, as their CEOs who pose more operating power than their predecessors. It is of academic significance to investigate if CEO characteristics have similar impact on firm performance as in the developed economies. As articulated in Chapter 1, the following research questions will be investigated in this research study.

1. Is the structure of ownership significantly associated with the performance of Chinese listed companies?

2. Is the ownership concentration significantly associated with the performance of Chinese listed companies?

3. Are the CEO characteristics significantly associated with performance of Chinese listed companies?

The effects that managerial ownership has on the value of a firm attract particular research interest in the literature of corporate finance. It seems there is a consensus that there are different interests among the shareholders and managers or a
firm, but their demands do not concur. Different interests with stakeholders produce organizational concerns which may affect the performance of a firm. An increase in management ownership may be helpful for connecting the interests of shareholders and insiders that leads to better decisions and greater value of a firm. When management ownership increases to an extent which provides management with enough shares they will pursue their personal benefits with less concern about the value of the firm. When this managerial ownership rises to a greater level, agency problems will emerge and destroy the alignment of the demands by stakeholders and the management. It is hypothesized that in the listed companies in China, between management ownership and value of a firm there is an identifiable nonlinear relationship (Easterby and Thorpe, 2008).

Managerial ownership is a way in which companies in China adapt to the corporate governance practices in the West but the portion of managerial ownership is relatively small in companies that are owned by the state. During the period from 2002 to 2007, the mean value was 0.0929, compared to the mean value of managerial ownership for companies that were run by private entrepreneurs. In comparison to the state owned enterprises, firms operated by 104 private entrepreneurs have more autonomy in terms of retention of profit and managers are appointed based on merits rather than political patronage (Creswell, 20097). Most of the firms that are run by private entrepreneurs adopt a practice for managerial ownership. Managers of these companies possess more power when compared to their counterparts in state owned enterprises. This enables the leadership of firms under the management of private entrepreneurs to have more influence on pricing, finance and human resource activities (Creswell, 2005).
Research question one is about the relationship between the structure of ownership and the performance of Chinese listed firms. In order to address this question, the following hypotheses are developed.

Hypothesis 1: The performance of Chinese listed companies is positively related with the proportion of shares owned by institutions.

Hypothesis 2: The performance of Chinese listed companies is positively related with the proportion of shares owned by private individuals.

Hypothesis 3: The performance of Chinese listed companies is positively related with the proportion of shares owned by managerial employees.

Hypothesis 4: The performance of Chinese listed companies is positively related with the proportion of shares owned by foreign investors.

Creswell (2005) clarifies that overseas shareholders are beneficial to Chinese firms in terms of creating the desire for relatively admirable corporate management practices. Furthermore, they are a source of advanced knowledge and experience that are vital for these firms. A directly related research philosophy is significant for this study since the focus is on the desire to identify association within options through quantitative practices. Creswell (2009) proposes that a quantitative positivist method is vital in directing the research to obtain objective findings. The research depends on the
scientific approach, hypothesis evaluation, quantitative analysis and consistent evaluation instruments (Creswell, 2009). To test the effect of foreign ownership on the performance of Chinese listed firms, hypothesis 5 is developed.

Hypothesis 5: The performance of Chinese listed companies is negatively related with the proportion of shares owned by the state.

Research question 2 deals with the relationship between ownership concentration and the performance of Chinese listed firms. The ownership in Chinese firms comprises of varied cadres of stakeholders. The government has consistently maintained a huge portion of the ownership. It is argued that public administrators who act as representatives of the state for the government controlled ownership are not competent to handle organizational management (Davies, 2007). In order to address this question, the following hypothesis 6 is developed.

Hypothesis 6: The performance of Chinese listed companies is positively related with the concentration of shareholding. Huson et al (2004) opine that a firm’s performance is a function of the factors of its CEO. Research question 3 deals with the effect of CEO characteristics on the performance of Chinese listed firms. The following hypotheses have been developed and will be tested in an attempt to find an answer for research question 3.

Hypothesis 7: The performance of Chinese listed companies is positively associated with the age of the CEO.
Hypothesis 8: The performance of Chinese listed companies is positively associated with the gender of the CEO.

Hypothesis 9: The performance of Chinese listed companies is positively associated with the experience of the CEO.

Hypothesis 10: The performance of Chinese listed companies is positively associated with the qualification of the CEO.

Hypothesis 11: The performance of Chinese listed companies is positively associated with the internal CEO appointment, represented in the form of a family member of the largest shareholder.

3.11 Variables Used for the Study

Quantitative methods have been adopted in the study to evaluate and ascertain the hypotheses using the positivist paradigm. This will happen through the adoption of joint dated Chinese firms, waning of growth variables on concentration of ownership. The financial implications of return on assets (ROA) and adjusted return on assets (CROA) are significant in evaluating performance. ROA is the ratio of the net operating profit before tax to total assets (Creswell, 2005). CROA embraces operating profits from fundamental activities in the calculations (Davies, 2007). However, in the context
of China, the results may be biased if ROA or CROA is used as many Chinese listed companies tend to divert into other non-core business sectors after listing. It is quite difficult to identify and exclude profit from non-core activities from their financial statements. Therefore, the financial indicator that is the most appropriate performance indicator is Return on Equity (ROE) as it simply reflects the efficiency of the capital employed. Accordingly, ROE has been used in this study as the performance indicator.

This research study uses regression analysis to evaluate if there are statistically proven discrepancies of performance within Chinese listed firms that have different ownership portions. The regression equation used for analysis is: Performance = f (ownership variables) where performance is measured in ROE.

Regression Analysis

For analyzing the relationship between the different variables, the researcher has used SPSS version 16. This is an instrument that is used in understanding the relationship within variables and is often used as a tool for prediction. In the simplest case, we study the linear correlation among predictor and dependable option (criterion) to determine if knowledge of the results for the first can predict with a satisfactory degree of accuracy, the results that we should observe about the second (Denzin and Lincoln, 2003).
3.12 Sampling

This research study concentrates on recent data about Chinese listed firms. As at the end of 2010, the number of companies listed on the Shanghai Stock Exchange were 894, which had increased to 953 by the end of 2013. At the Shenzhen Stock Exchange, 1169 companies were listed at the end of 2010 and by the end 2013 the number had increased to 1,536 (source: CSRC Yearbook). Section 2.4 of Chapter 2 provides a summary of the respective number of listed companies and turnover of the Shanghai Stock Exchange and Shenzhen Stock Exchange during the period from 2005 to 2013, based on year-end statistics.

A total of 502 companies have been excluded from this survey as they have either experienced suspension or not been consecutively profitable during the survey period. All remaining listed companies that have been listed and consistently traded on the Shanghai and Shenzhen Stock Exchanges during the period of study of 2010-2012 have been included in this survey. This implies that there is no issue with sampling in the survey. In the survey of the interrelatedness of Chinese listed firms’ performance and ownership arrangements Davies (2007) covers the entire stock exchange markets. Wang (2003) and Bai et al (2004) also include the entire listed firms on the stock exchange markets.

This longitudinal survey is concerned with evaluating considerate growth of firms and provision of a scientific evaluation. Easterby and Thorpe (2008) indicate that the main advantage of longitudinal evaluation of information is its capacity to trace alterations.
3.13 Data and Method of Collection

For purposes of this survey, the year-end data have been used to ensure data consistency. Furthermore, the Chinese accounting system adopts a December year-end practice. The year-end data provide a full aspect of a firm’s performance during the year that is pertinent to the purpose of the research study.

The data used in this research survey are secondary generated unrestricted information and have been extracted from secondary sources. They have been gathered from a multitude of sources including China Securities Regulatory Commission (“CSRC”), the Shanghai Stock Exchange, the Shenzhen Stock Exchange and the annual records of Chinese listed firms. The CSRC and the two stock exchanges are the official and relevant government agencies that supervise, regulate and control all the listed companies in China. Information from these institutions is authentic and official. On the other hand, the annual reports of the Chinese companies have been prepared by the companies themselves but have to undergo verification as stipulated under the code of regulations of the CSRC. The verification process is meant to ensure that all information released by the listed firms is genuine and reliable.

3.14 Reliability

All data and information used in this survey are based on prevailing data collected by a third entity. Data reliability is ensured through scrutinizing the manner by which the data were collected and the credibility and authenticity of the party that collected the data. Furthermore, reliability in information is evaluated to facilitate a
process that is devoid of subjectivity. Reliability is also determined to facilitate a situation where data will remain the same in case of a repeated data gathering process. An evaluation of the structures and methods embraced during the gathering of information enables the investigator to determine consistency (Creswell, 2005).

Reliability is an indicator that measures internal consistency (Cooper and Schindler, 2006). However, qualitative researchers accept that different researchers using alternative measures will get distinctive results (Creswell, 2005). Although reliability is concerned with stability and consistency in measurement, it may still be subject to error because of respondent mistakes, respondent prejudice and witness mistakes and witness prejudice (Denzin and Lincoln, 2005). In line with Davies (2007) it has been endeavored to meet the criteria for reliability through the following measures:

The data for companies have been collected from reliable sources, and have been used for answering the questions of this research study.

Combining secondary and quantitative methods in a complementary manner and by drawing on the strengths of both the methods, the research design has provided for more valid and reliable findings (Easterby and Thorpe, 2008). The secondary research approach provides the useful insights on the research conducted. The quantitative design on the subsequent process of the survey requires collection of value-free information (Denzin and Lincoln, 2003).
3.15 Validity

Validity is founded to ensure that implications are developed on the basis of the reactions. Reliability can be determined through the following means. To begin with, knowledge reliability is determined to facilitate the correct evaluation of the desired aspects. Information is reviewed to develop this evaluation. Secondly, simultaneous reliability is assessed to facilitate uniformity of the findings with other information (Creswell, 2009). Furthermore, an assessment of the information is done to determine simultaneous reliability. Distinctively, both previous monthly and annual information are excluded.

Validity with reliability is usually complementary, but at times they may conflict with each other (Creswell, 2005). It is common for concerns to rise that touch on the validity of the research and cases of prejudice among the respondents and the researcher. The first type is descriptive validity. The first concern of many qualitative researchers is the commitment to the details of their study. This means that there should be minimal alterations of the details during gathering of information. Secondly, Maxwell identifies the interpretative form of validity. Under this the focus is on the opinions and real inferences of the data that is collected from the participants. Thirdly, there is theoretical validity (Davies 2007).

Creswell (2005) agrees with this by arguing that it is a theory of some phenomenon. Final variations of recent theories have been embraced by scholarly schools of thought. The fourth is evaluative validity. According to Creswell (2009), this is not a very serious aspect however it is also vital when augmented with the other types of validity. Creswell (2005) suggests that reliability is the level at which the
outcomes of a survey can occur after a similar survey. In a qualitative survey repetition of the outcomes is minimal.

3.16 Triangulation

Triangulation referred to the use of different data collection methods within one study (Easterby and Thorpe, 2008). Triangulation provides support to the findings by showing them the independent measures that agrees to it or at least do not contradict (Denzin and Lincoln, 2003). To circumvent the personal biases of investigators and to overcome the deficiencies that are intrinsic to a single-investigator, single-theory, or single method study for the purpose of increasing the validity of the findings (Davies, 2007). Therefore, in a bid to progress the validity of the data collected, this research study has adopted:

- Data triangulation to enhance constructs validity through the use of data from multiple sources, to include primary data obtained from the secondary data from the literature review.

- Methodological triangulation increases internal and external validity and reliability. This includes the triangulation of using the mixed methods of qualitative and quantitative approaches (Creswell, 2009).
3.17 Ethical Implications

The survey employs secondary data existing in the public forums and it concentrates on surveying the entire growth of the entire companies in China instead of focusing on a single firm. Secondary sources of information are that which had previously used for other objectives but which may still be useful to the research project under consideration. In addition, finding the information needed to answer a particular research question from secondary data avoids the need to spend time and money on primary research (Creswell, 2005). Further, the research results of this study would not be subjected to popular forums. There is no need for questionnaires since it is based on historical information.

There is no personal identification of participants to identified questions. This therefore implies that desire for seeking the approval from someone does not apply. The research will not be based on privately held information. Any information that will be embraced in the research will be retrieved from publicly acknowledged sources. This therefore implies that there will be minimal conflict interests with the researcher. The only participation expected from companies is the provision of the audited reports hence physical interaction with these companies is insignificant (Easterby and Thorpe, 2008).

3.18 Significance

The results from the survey are evaluated in accordance with the theoretical reasons that aim at answering most of the concerns under study in this research. One of the concerns is that information gathering methods and analysis should observe
objectivity and reliability standards. Creswell (2005) indicates that an implication of a study depends on how the study attained detailed investigation methods. When sorting data it is important that to be careful to avoid distorting data collected during the survey.

3.19 The Research Model

In this dissertation, corporate performance is represented by ROE, which is defined as net income divided by the average owner’s equity during a year. This is similar to what is recognized by Grant (1987), Lee and Cooperman (1989) and Megginson et al (1994). ROA and market-to-book ratio (Tobin’s Q) are used as option towards company performance as the outcomes are qualitatively similar. However, as explained previously in this dissertation, there are practical limitations in using ROA or CROA to measure firm performance as China’s accounting practice is still not in strict compliance with international standards. Likewise, Tobin’s Q also has limitation in that the Chinese stock market is sensitive to government policy. This renders market value not a good objective measurement tool. The standard values at the initial and final stages of the year are used for INSTIT (institutional shareholdings), ASHARE (private shareholdings), MSHARE (managerial shareholdings), FOREIGN (foreign shareholdings), STATE (state shareholdings), CON (shareholding of the largest shareholder), CEO_AGE (age of the CEO), CEO_SEX (gender of the CEO), CEO_EXP (experience of the CEO), CEO_QUAL (education level of the CEO), and CEO_APP (internal CEO appointment) in all regressions.

Some other variables such as research and development expenditure that are practically difficult to obtain from the company account or annual reports of Chinese listed companies have not been used in the regression analysis. In examining firm
performance with respect to the various independent variables, the regression equation adopted is by pooling observations longitudinally.

Yin (2007) uses a regression model to study the relationship between performance and ownership structure of listed companies in China and uses 652 sample firms listed on the Shanghai Stock Exchange for his test. He identifies split share structure, large state shareholding, and unsound market system as the key negative factors impairing corporate governance practice and efficiency of Chinese listed firms.

Research question 1 deals with the effect of ownership structure on firm performance. For this purpose the following regression equation is used.

$$ROE_{it} = \beta \pm \alpha_1 INSTIT_{it} \pm \alpha_2 ASHARE_{it} \pm \alpha_3 MSHARE_{it} \pm \alpha_4 FOREIGN_{it} \pm \alpha_5 STATE_{it} \pm \delta$$

(1)

Where \(ROE_{it}\) stands for the ROE of firm \(i\) in year \(t\)

ROE – Return on Equity (in percentage)

INSTIT - institutional shareholdings (in percentage)

ASHARE - private shareholdings (in percentage)

MSHARE - managerial shareholdings (in percentage)

FOREIGN - foreign shareholdings (in percentage)

STATE - state shareholdings (in percentage)
\( \alpha_1, \alpha_2, \alpha_3, \alpha_4, \alpha_5 \) are called regression coefficients.

\( \beta \) and \( \delta \) are called the error terms, disturbance terms, or noise. These variables capture all other factors which influence the dependent variable ROE other than the regressors.

Research question 2 deals with the effect of ownership concentration on firm performance. Research studies by Djankov and Claessens (1999), and Zeitun (2009) identify a significant relationship between ownership concentration and firm performance. Dzanic (2011) examines the relationship between ownership structure and firm performance using a sample of firms listed on the Zagreb Stock Exchange for the period 2003 to 2009 and identify a significant negative relationship between the existence of a block shareholder and firm value. In a similar fashion, for purposes of testing the relationship between ownership concentration and performance of Chinese listed firms, the following regression equation is developed.

\[
ROE_{it} = \beta_1 \pm \alpha_1 L1_{it} \pm \alpha_2 L2_{it} \pm \alpha_3 L3_{it} \pm \alpha_4 LA_{it} \pm \beta_2 K1_{it} \pm \beta_3 K2_{it} \pm \beta_4 K3_{it} \pm \delta_{it}
\]

(2)

Where \( ROE_{it} \) stands for the ROE of firm \( i \) in year \( t \) while \( L_{it} \) represent alternative measures of ownership concentration in select alternative specifications.

Where

L1 = the proportion of shares owned by the largest shareholder

L2= the aggregate shareholdings of the two largest shareholders.

L3= the aggregate shareholdings of the three largest shareholdings
K1= shareholdings of the first largest shareholder

K2= shareholdings of the second largest shareholder

K3= shareholdings of the third shareholder

$\alpha_1, \alpha_2, \alpha_3, \alpha_4, \alpha_5, \beta_2, \beta_3, \beta_4$ are called regression coefficients

$\beta_1, \text{ and } \delta$ are called the error terms, disturbance terms, or noise. These variables capture all other factors which influence the dependent variable $ROE$ other than the regressors.

Research question 3 deals with effect of CEO characteristics on firm performance. Studies by Fauzi and Locke (2012) reveal that board of the board of directors, board committees, and managerial ownership have a positive and significant impact on firm performance. In a similar fashion, the following regression equation is established.

$$ROE_{it} = \beta + \alpha_1 CEO\_AGE_{it} + \alpha_2 CEO\_SEX_{it} + \alpha_3 CEO\_EXP_{it} + \alpha_4 CEO\_QUAL_{it} + \alpha_5 CEO\_APP_{it} + \delta$$

(3)

Where $ROE_{it}$ stands for the ROE of firm $i$ in year $t$

Where

ROE= Return on Equity

$CEO\_AGE$ = Age of the CEO

$CEO\_SEX$ = Gender of the CEO

$CEO\_EXP$ = Experience of the CEO
\( CEO\_QUAL \) = Education level of the CEO

\( CEO\_APP \) = Internal Appointment

\( \alpha_1, \alpha_2, \alpha_3, \alpha_4, \beta_2, \beta_3, \beta_4 \) are called regression coefficients

\( \beta \) and \( \delta \) are called the error terms, disturbance terms, or noise. These variables capture all other factors which influence the dependent variable \( ROE \) other than the regressors.

### 3.20 Conclusion

The methodology used in the research survey has been described and explained in this chapter. It embraces a secondary quantitative survey approach and applies regression analysis to identify the performance of those Chinese companies listed on the two local stock exchanges with respect to ownership structure, ownership concentration, and CEO characteristics. Regression equations have been established for testing the hypotheses developed. This will enable actual testing to be carried out.
CHAPTER 4: CORPORATE PERFORMANCE

In this research study, I aim to investigate the impact of various ownership structures towards the performance of listed companies in China. The study period is from 2010 to 2013. This period has been chosen for several reasons. Firstly, these years are most recent so that the data will better reflect the current situation. Secondly, there have been significant changes in the financial reporting policies and requirements in China in the end of 1990s (Neoh, 1999; Milicic and Rich, 1999; Long, 2001) such that data extracted from that period may not be consistent. Thirdly, although China has been moving towards opening the domestic stock markets in line with international practice, it was not until 2005 that non-tradable share reform started to take place. Before that, there were conflicted interests between tradable shareholders, being mostly private investors, and non-tradable shareholders, which were mainly governments and state-owned enterprises. The conflicted interests between different shareholder groups and the existence of information asymmetry had rendered corporate governance hard to be established. Fourthly, due to the global economic crisis in 2008, global stock markets had gone through a protracted period of instability resulting in market data being susceptible to distortion. Although the Chinese stock markets were not fully open to international investors and hence less impacted, still the effects were felt. Therefore, 2008 and 2009 have not been included in the period of study in order to avoid data distortion. Companies that have been suspended, as well as listed banking stocks which only issued “B” shares have been excluded in the research study. The number of companies excluded is limited and the sample practically covers all the listed companies by and large.
4.1 Corporate Performance With Respect to Owner Structure

One major objective of this research study is to identify the financial impact of various ownership structures on the performance of companies listed on two local stock exchanges. The main hypothesis developed for this purpose is to identify if there exists a significant relationship between the ownership structure and performance of Chinese listed companies.

Five hypotheses have been developed for testing this main hypothesis.

Hypothesis 1: The performance of Chinese listed companies is positively related with the proportion of shares owned by institutions.

Hypothesis 2: The performance of Chinese listed companies is positively related with the proportion of shares owned by private individuals.

Hypothesis 3: The performance of Chinese listed companies is positively related with the proportion of shares owned by managerial employees.

Hypothesis 4: The performance of Chinese listed companies is positively related with the proportion of shares owned by foreign investors.

Hypothesis 5: The performance of Chinese listed companies is negatively related with the proportion of shares owned by the state.
Five independent variables are created in the regression equation that is used for testing this main hypothesis. They are: institutional shareholdings, private shareholdings, managerial shareholdings, foreign shareholdings, and state shareholdings.

\[
ROE_{it} = \beta + \alpha_1 \text{INSTIT}_{it} + \alpha_2 \text{ASHARE}_{it} + \alpha_3 \text{MSHARE}_{it} + \alpha_4 \text{FOREIGN}_{it} + \alpha_5 \text{STATE}_{it} + \delta
\]  
(1)

Where \(ROE_{it}\) stands for the ROE of firm \(i\) in year \(t\)

ROE – Return on Equity (in percentage)

INSTIT - institutional shareholdings (in percentage)

ASHARE - private shareholdings (in percentage)

MSHARE - managerial shareholdings (in percentage)

FOREIGN - foreign shareholdings (in percentage)

STATE - state shareholdings (in percentage)

\(\alpha_1, \alpha_2, \alpha_3, \alpha_4, \alpha_5\) are called regression coefficients

\(\beta\) and \(\delta\) are called the error terms, disturbance terms, or noise. These variables capture all other factors which influence the dependent variable ROE other than the regressors.

These variables represent the major ownership structures that currently exist in China. The measurement of these variables is based upon the following definitions:
Foreign shareholdings - Foreign shareholdings refer to the proportion of the aggregate shares of equity that are owned by foreigners with respect to aggregate shares issued and include shares owned by individual foreign shareholders, foreign partners, and foreign financial institutions.

Government shareholdings - Government shareholdings represent the proportion of shares owned by the government with respect to aggregate shares issued. Government shareholdings include shares held by financial institutions, insurance companies, banks, mutual funds, state-owned enterprises that are owned by the state.

Institutional shareholdings - Institutional shareholdings are equity shares held by domestic Chinese financial institutions and fund houses as a percentage of total equity shares issued.

Managerial shareholdings - Managerial shareholdings refer to equity shares held by senior managerial staff and include shares that are owned by family members of the directors of the listed companies concerned.

The dependent variable used for the purpose of this study is one that reflects the “the firm value”. A firm’s value is measured by its financial performance. There are many financial indicators used as a means of determining the performance. The two financial indicators that include Adjusted-Return-on-Assets (CROA and Return-on-Assets (ROA) can be used to calculate the performance. ROA refers to the ratio of net operating profit before tax to total assets. Arguably it is the best method of determining accountability in comparison to return on equity (ROE) (Davies, 2007). CROA mainly
make use of the operating profit from major activities in the measurement. Profit from activities that are not core is not included. The indicator can determine the organizations performance in core activities. However, in the context of China, the results may be biased if ROA or CROA is used as many Chinese listed companies tend to divert into other non-core business sectors after listing. It is quite difficult to identify and exclude profit from non-core activities of the firm simply from its published financial statements. Practically, the financial indicator that is most appropriate performance indicator is Return on Equity (ROE) as it simply reflects the efficiency of the capital employed. Accordingly, ROE has been used in this study as the performance indicator. Return on Equity (ROE) as a means to measure to evaluate corporate performance is supported by Bianco and Casavola (1999), Krivogorsky(2006), Aydin et al (2007) and Omran et al(2008).

Return on Equity (ROE)

\[
ROE = \frac{PB\text{DIT}}{EC}
\]  

EC = Equity Capital

In research studies where the researcher is attempting to estimate the extent of variable, the determination of a major variable (the variable to be predicted) as well as the combination and correlations of predicting variables is very important. The testing method used in this study, which combines the predicting variables is “linear regression.”
For determining the regression equation for this study, the following formula has been established:

\[
Y = a + b_1 x_1 + b_2 x_2 + \ldots + b_n x_n
\]  
(5)

\(Y\): company performance

\(a\): Constant

\(x_1, x_2, \ldots, x_n\): all independent variables included in this study

\(b_1, b_2, \ldots, b_n\): coefficients of the achieved regressions for all variables used in this study.

Statistical data can be managed in three different ways: the panel approach, cross-sectional and time series. For the purpose of this research study, in consideration of the data type and analytical approach, the cross-sectional data method has been chosen.

A researcher may select suitable estimates using different tests such as the Hausman test or the Breusch-Pagan Lagrange Multiplier (LM) test. After a suitable model has been selected, the continuity of the time series and the reliability of the regression should be strictly observed.

As articulated in Chapter 3, the regression model developed for purposes of this study is presented below:

\[
ROE_{it} \equiv \beta \pm \alpha_1 \text{INSTIT}_{it} \pm \alpha_2 \text{ASHARE}_{it} \pm \alpha_3 \text{MSHARE}_{it} \pm \alpha_4 \text{FOREIGN}_{it} \pm \alpha_5 \text{STATE}_{it} \pm \delta
\]  
(1)
Where ROE\(_{it}\) stands for the ROE of firm \(i\) in year \(t\)

ROE – Return on Equity (in percentage)

INSTIT - institutional shareholdings (in percentage)

ASHARE - private shareholdings (in percentage)

MSHARE - managerial shareholdings (in percentage)

FOREIGN - foreign shareholdings (in percentage)

STATE - state shareholdings (in percentage)

\(\alpha_1, \alpha_2, \alpha_3, \alpha_4, \alpha_5\) are called regression coefficients

\(\beta\) and \(\delta\) are called the error terms, disturbance terms, or noise. These variables capture all other factors which influence the dependent variable ROE other than the regressors.

The determining coefficients are criteria which explain the strength of the association that exists between independent variables and dependent variables. The magnitude of this coefficient, in fact, determines what percentages of changes of the independent variables are justified by variables that are independent.

The significance of the regression equation, as determined by F-statistic and related hypothesis is as follows:

\[ H_0 : \beta_1 = \beta_2 = \cdots = \beta_k = 0 \]
If $H_0$ is rejected (with 95 percent probability), the regression equation is significant. After implementing the regression significance test, the regression of each of the coefficients will be tested. The test hypotheses are:

$H_0$: $\beta_i = 0$ The population coefficient is zero

$H_1$: $\beta_i \neq 0$ The population coefficient is not zero

For the testing of these hypotheses, the “$t$” test is employed. In this test (with 95 percent probability) if $H_0$ is not rejected, it means that the coefficient concerned is not significant whereas a rejection means the opposite.

In principle all listed firms in China are to be included in this research study because the purpose is to identify the general pattern of Chinese listed firms. In practice, some firms have been excluded because they are considered to be biased or unsuitable samples. For example, banks have been excluded as they only issued “B” shares. For purpose of this study, the following criteria are employed for selection of firms.

1. The listed should be continuously listed on China’s stock exchanges up to the end of 2013.

2. The book value of the stockholders equity is not negative in any year.

3. They must have continual activities during the study period.

4. They have not changed their financial year during the study period.

5. They have not stopped their activities during the time of the study.

7. They remain profitable throughout the period of the study.

Data for this study are extracted from the following sources:

(1) China Stock Market and Accounting Research (CSMAR) database;

(2) Multiple sources of financial databases;

(3) China Securities Regulatory Commission published statistics; and

(4) Annual report of the listed companies.

**Reliability Test**

Before the testing, the reliability of the continuity of the dependent variables is tested. Reliability test of the variables reveals that the means and variances of the variables during the period of survey, and the covariance of the variables in different years are stable.

**Hypothesis 1 testing**

Hypothesis 1: The performance of Chinese listed companies is positively related with the proportion of shares by institutions.
## Correlations

<table>
<thead>
<tr>
<th></th>
<th>ROE</th>
<th>INSTIT</th>
<th>ASHARE</th>
<th>MSHARE</th>
<th>FOREIGN</th>
<th>STATE</th>
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<tbody>
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<td>ROE Pearson Correlation</td>
<td>1</td>
<td>.104**</td>
<td>.591**</td>
<td>-.037</td>
<td>.009</td>
<td>-.293**</td>
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<td>Sig. (2-tailed)</td>
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<td>.000</td>
<td>.260</td>
<td>.793</td>
<td>.000</td>
</tr>
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<td></td>
<td>N</td>
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<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
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<td>INSTIT Pearson Correlation</td>
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<td>.045</td>
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<td>.166</td>
<td>.935</td>
<td>.874</td>
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<td>.038</td>
<td>.021</td>
<td>-.056</td>
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<td>.367</td>
<td>.472</td>
<td>.086</td>
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<tr>
<td>FOREIGN Pearson Correlation</td>
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<td>-.056</td>
<td>-.047</td>
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Table 4.1(a) Relationship among foreign ownership, institutional ownership, private ownership, managerial ownership, state ownership and ROE

**. Correlation is significant at the 0.01 level (2-tailed).

### Model Summary

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<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
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<td>.501</td>
<td>.498</td>
<td>.488</td>
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a. Predictors: (Constant), STATE, ASHARE, FOREIGN, INSTIT, MSHARE

### ANOVA

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<th>Sig.</th>
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115
## Model Summary

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<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
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<td>1</td>
<td>.708$^a$</td>
<td>.501</td>
<td>.498</td>
<td>.488</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), STATE, ASHARE, FOREIGN, INSTIT, MSHARE

b. Dependent Variable: ROE

## Coefficients$^a$

<table>
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<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
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<th>Sig.</th>
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<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td>Beta</td>
</tr>
<tr>
<td>1 (Constant)</td>
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<td>.102</td>
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<td>10.072</td>
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<tr>
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<td>.027</td>
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<td>ASHARE</td>
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<tr>
<td>MSHARE</td>
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<td>.029</td>
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<td>2.714</td>
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Table 4.1 (b) The coefficients for the regression model

<table>
<thead>
<tr>
<th></th>
<th>ROE</th>
<th>INSTIT</th>
<th>ASHARE</th>
<th>MSHARE</th>
<th>FOREIGN</th>
<th>STATE</th>
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<td>.591**</td>
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<td>.009</td>
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<td></td>
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<td>.000</td>
<td>.260</td>
<td>.793</td>
<td>.000</td>
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<td></td>
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<tr>
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<td>.061</td>
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<td>Sig. (2-tailed)</td>
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<tr>
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<tr>
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Table 4.1(a) Relationship among foreign ownership, institutional ownership, private ownership, managerial ownership, state ownership and ROE

**. Correlation is significant at the 0.01 level (2-tailed).

Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
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<tr>
<td>1</td>
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<td>.498</td>
<td>.488</td>
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</table>

a. Predictors: (Constant), STATE, ASHARE, FOREIGN, INSTIT, MSHARE
### ANOVA\(^b\)

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
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<td>5</td>
<td>44.868</td>
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<td></td>
<td>Residual</td>
<td>223.611</td>
<td>939</td>
<td>.238</td>
<td></td>
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<td></td>
<td>Total</td>
<td>447.951</td>
<td>944</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), STATE, ASHARE, FOREIGN, INSTIT, MSHARE

b. Dependent Variable: ROE

### Coefficients\(^a\)

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>1.027</td>
<td>.102</td>
<td>10.072</td>
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<tr>
<td></td>
<td>INSTIT</td>
<td>.297</td>
<td>.027</td>
<td>.342</td>
</tr>
<tr>
<td></td>
<td>ASHARE</td>
<td>.144</td>
<td>.033</td>
<td>.162</td>
</tr>
</tbody>
</table>
Table 4.1 (b): The coefficients for the regression model

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard Error</th>
<th>T-Value</th>
<th>p-Value</th>
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<tbody>
<tr>
<td>MSHARE</td>
<td>-.078</td>
<td>.029</td>
<td>2.714</td>
<td>.007</td>
</tr>
<tr>
<td>FOREIGN</td>
<td>.088</td>
<td>.027</td>
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<td>.001</td>
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<tr>
<td>STATE</td>
<td>.148</td>
<td>.023</td>
<td>6.457</td>
<td>.000</td>
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</table>

a. Dependent Variable: ROE

Table 4.1 (b): The coefficients for the regression model

Table 4.1(b) lists out the relevant empirical statistics with respect to the regression model applied in this research study. From the table, it can be seen that the coefficient of the independent variable “institutional ownership” is positive and significant. Therefore, it may be inferred that there exists a positive association between institutional ownership and firm performance. Considering the high level of R² and the positive coefficient of the independent variable of “institution shareholdings” in the model, it is argued that the higher the institutional ownership, the better the performance of the firm is. Hence, Hypothesis 1: “The performance of Chinese listed companies is positively related with the proportion of shares owned by institutions” is accepted. This finding is in accordance to the findings of other studies (Ahmadzadeh et al, 2005, and Mokarami, 2006) as far as the existence of a significant relationship is concerned.

That institutional ownership and firm performance are significantly and positively related should be interpreted in the context of China. Primarily these institutions are owned by the governments. In the past government owned institutions
had to take on other tasks such as maintaining market stability, hence leading to investments decisions that might not necessarily be driven by profit alone but could be for various purposes. However, in recent years, as a result of the continued development of the Chinese economy towards a market based one and the development of the stock markets in China, firms have to compete for resources in order to remain competitive in the market place. Government owned entities obviously have some advantages as they tend to get some favor from the respective level of government that owns the interest in them. In many cases, some companies at the local government level indeed are the primary money earner of the government concerned. The vested interest of the government will increase with the level of government ownership. In addition, because government owned entities usually pay better than private enterprises and offer better benefits to employees, they tend to hire better quality staff. This makes the level playing field a bit skewed to the disadvantage of non-government owned enterprises. Whereas in the past government owned enterprises might have some side goals hence compromising optimization of company resources, in recent years the government have learnt to derive economic benefits through maximizing return from the entities in which they have a shareholding. This explains why firm performance is positively related with the proportion of shares owned by institutions who are the proxy of the government.

**Hypothesis 2 testing**

Hypothesis: The performance of Chinese listed companies is positively related with the proportion of shares owned by private individuals.

Based upon table 4.1(b), the coefficient for "private ownership" which is an independent variable is significant and positive. Thus, it is inferred that there exists a positive association between firm performance and private ownership. Furthermore,
since $R^2$ is high and the coefficient of the independent variable of company ownership is positive and significant, it can be interpreted that firm performance will improve with the increased level of private ownership in the firm. Therefore, **Hypothesis 2: “The performance of Chinese listed companies is positively related with proportion of shares owned by private individuals” is accepted.** This relationship may simply be explained by basic economic rules. Private enterprises in China usually have only one goal which is to seek maximization of profits. Private investors care about their own money than any others and their interests are also aligned.

**Hypothesis 3 testing**

As table 4.1 (b) illustrates, the model shows a significant and negative coefficient for the independent variable of managerial ownership. Since $R^2$ is high and the coefficient is significant and negative, it can be inferred that there exists a negative association between managerial ownership and firm performance. When managerial ownership increases, an organization’s performance tends to become weaker. Therefore, **Hypothesis 3: “The performance of Chinese listed companies is positively related with the proportion of shares owned by managerial employees” is rejected.**

These results are in accordance with Khan et al (2007). However, they are not in accordance with the research results of Bhagat (1983), Mcconaughy et al (2001), Anderson and Reeb (2003), and Mueller and Spitz-Oener (2006). A reason for this inconsistency could be that most of the companies with managerial ownerships in the samples under study are family companies where the majority ownership of the firm belongs to one family or a group of family members. This characteristic is a classic corporate governance issue under the agency theory. This type of managerial ownership
is akin to family control rather than professional managerial ownership. Typically the
managers are members of the controlling family. They have a strong incentive to seek
payback from the company at the price of other shareholders.

**Hypothesis 4 testing**

Hypothesis 4 is about the impact of foreign ownership on firm performance. Table 4.1 shows that foreign ownership has no significant effect on the ROE. The relationship between foreign ownership and ROE cannot be ascertained with statistical significance. Therefore, **Hypothesis 4: “The performance of Chinese listed companies is positively related with the proportion of shares owned by foreign investors” is rejected.** It is interesting to note that foreign ownership had in the past been perceived as being efficient and market leading. The insignificance of the outcome implies domestic and foreign ownerships make little difference now.

**Hypothesis 5 testing**

A similar approach is adopted for testing this hypothesis. Based upon the statistics in table 4.1, it may be concluded that since the coefficient of state ownership in the model is significant and negative (at $\alpha = 0.5$), it implies there exists a negative association between state ownership and performance. Since $R^2$ is high and the coefficient of the independent variable of company’s ownership is significant and negative, it follows that the higher the state ownership the weaker a firm’s performance is. Therefore, **Hypothesis 5: “The performance of Chinese listed companies is negatively related with the proportion of shares owned by state” is accepted.** These findings are in agreement with the findings of most previous research studies but are inconsistent with a study done by Cheung et al (1999).
From a statistical standpoint, both institutional and private ownerships return a positive and significant coefficient implying there exists a positive relationship with firm performance. However, while a qualitative inference can be drawn through interpreting the test results, it is still not possible to identify whether a certain kind of ownership increases or decreases firm performance. The test results go so far as to reveal a statistically significant relationship but cannot tell whether or not a certain ownership structure leads to better corporate performance. The findings also agree with the results of most previous research studies; but disagrees with the results of some studies like Earle (1998), Omran et al (2008) and Rahchamani (2006).

In the context of China, most, though the proportion is decreasing, institutional investors are, directly or indirectly, owned by various levels of governments or their agencies. At the least, due to the tightly regulated financial industry in China that is characterized by strong government intervention, decisions made by these institutions are not necessarily based on economic merits, as opposed to the case of most international institutions. Accordingly, the statistical relationship with performance may be susceptible to be distorted.

In the case of “managerial shareholding”, basically the overwhelming managerial investors are indeed members of the controlling families. In other words, they are not professional managers who are unrelated to the controlling shareholding family. This goes back to the classic corporate governance problems in agency theory where the managers are part of the leading shareholders susceptible to expropriation of minority shareholders’ interests. This explains why as “managerial shareholding”
increases, firm performance tends to get weaker. It may be said that this ownership structure is analogue to concentration of shareholding.

The significance of studying the impact that ownership structure has on the performance of an organization is worth being noted. It provides ex-post practical evidence regarding the association that exists between ownership structure and a firm’s performance. It also provides an indication of the direction of the reform of ownership structure by making reference to firm performance. Although the study may not lead to a powerful conclusion as to what kind of ownership structure is the best in the context of China, due to the influence of various factors, still it is apparent that firm performance tends to become better as government ownership transcends to private ownership. This study provides valid empirical evidence concerning corporate governance among Chinese listed firms and leads to other ownership related subjects that might have an impact on the performance of a Chinese firm. The following is a list of suggested subjects for further study.

1. Whether or not industry type can have an influence on the association between ownership structure and the performance of a firm.

2. The investigation of other dependent variables that should be considered when investigating the association between firm performance and ownership structure.

3. The employment of other performance evaluation variables.

4. Investigation on main economic variables such as inflation, oil prices and currency exchange rates that may have an influence on the association between firm performance and ownership structure.

5. Studying and testing the association between firm performance and ownership structure for short–term periods (less than a year).
6. Studying and testing the impact of ownership structure towards the performance of loss making firms with respect to profitable companies by deployment of virtual variables.

4.2 Corporate Performance with Respect to Ownership Concentration

Research question 2 deals with the relationship between ownership concentration and performance of Chinese listed companies. To answer this question, the following hypothesis will be tested.

Hypothesis 6: The performance of Chinese listed companies is positively related with the concentration of shareholdings.

The methodology adopted in testing the effect of ownership concentration on firm performance is based on a similar study done by Earle et al (2005) on companies listed on the Budapest Stock Exchange. There is striking resemblance in terms of ownership structure of the listed companies in Hungary and China and the historical background against which the stock exchanges in Budapest and China have developed. Both countries of Hungary and China had similar political systems in the past and are headed towards a market based economy, though the respective regimes have different political ideologies. The outcome of this research study on ownership concentration may be compared with the study done by Earle et al to provide some insight as to whether there are some common patterns pertaining to listed companies in different countries but not pertaining to the political regime under which they operate.
Since the performance of firms is measured on a yearly growth basis, in order to ensure consistency, the mean of the ownership variables from year’s \( t \) and \( t-1 \) will be taken for purpose of this study. This has the effect of averaging out the interference of data extremity.

Given that the ownership of China listed firms is quite concentrated, it is expected that the few largest shareholders will represent the majority of shareholdings. Accordingly, this study includes up to four of the largest shareholders of the listed firms. \( L1 \) represents the proportion of shares owned by the largest shareholder while \( L2 \) denotes the aggregate shareholdings of the two largest shareholders. The rationale is that in many instances the largest shareholder does not necessarily hold a majority shareholding. Chances are they will become a controlling block if their interest is combined with that of the second largest shareholder. \( L3 \) is created to represent the aggregate shareholdings of the three largest shareholdings. In most cases, this aggregate shareholding will have had a controlling stake in a listed company in this context. In addition, the respective shareholdings of the second and third largest shareholders’ are also measured (represented by \( K2 \) and \( K3 \), respectively) so as to determine their respective marginal impact on firm performance with respect to the largest shareholder whose shareholding is denoted by \( K1 \) (also equal to \( L1 \)). Finally the last measurement is the aggregate shareholdings of the four largest shareholders, represented by \( L4 \).

Table 4.2 shows the essential statistics for the various categorized concentration values across all years selected in this study. At the median, the largest shareholder owns 40.3 percent.
<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
<th>Mean</th>
<th>SD</th>
<th>Minimum</th>
<th>Median</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>L1</td>
<td>shares held by Largest Shareholder</td>
<td>36.2</td>
<td>19.4</td>
<td>0</td>
<td>40.3</td>
<td>71.1</td>
</tr>
<tr>
<td>L2</td>
<td>shares held by Largest and Second Largest Shareholder</td>
<td>51.1</td>
<td>23.1</td>
<td>0</td>
<td>55.9</td>
<td>89</td>
</tr>
<tr>
<td>L3</td>
<td>Sum of Shares held by Largest three shareholders</td>
<td>52.7</td>
<td>23.7</td>
<td>0</td>
<td>60.1</td>
<td>91.3</td>
</tr>
<tr>
<td>L4</td>
<td>Sum of Shares held by Largest Four shareholders</td>
<td>60.9</td>
<td>24.6</td>
<td>0</td>
<td>67.2</td>
<td>95.4</td>
</tr>
<tr>
<td>K2</td>
<td>shares held by Second Largest Shareholder</td>
<td>13.5</td>
<td>9.7</td>
<td>0</td>
<td>14.7</td>
<td>42.5</td>
</tr>
<tr>
<td>K3</td>
<td>Shares held by Second Largest and Third Largest Shareholder</td>
<td>48.2</td>
<td>5.1</td>
<td>0</td>
<td>3.9</td>
<td>48.7</td>
</tr>
</tbody>
</table>

Table 4.2 Statistics for categorized concentration measures

The minimum value for ownership is 0 which, by international stock market practice, is taken as any shareholding between 0 and 5%. From Table 4.2 above, it can be seen that the values of the means and medians are very high. The ownership of the largest shareholder is, in the context of most securities regulatory frameworks, considered very large. This indicates that there exists a significant ownership concentration. The second largest shareholder (K2) has a median value of 14.7. This value is much smaller than the median value of 40.3 of the largest shareholder but is nevertheless a significant value by all means, in terms of ownership in a listed company. The largest two shareholders already have in aggregate majority control of the firms, whether based on the value of the Mean or Median. This effectively diminishes the influence of the other shareholders who can only create noise (Earle et al, 2005). In general, across all international stock markets, anything above 5% will be considered
significant. By this standard, the third shareholder’s stake at 3.9% is not significant, though not negligible.

According to Zwiebel (1995), if the largest shareholder has such a large stake, the holdings of other shareholders would be insignificant, as the leading shareholder “creates its own space”. Earle et al (2005) cite a collection of the Median values of the listed companies in various jurisdictions summarized by Becht and Röell (1999) who report the median of the largest voting block is at 20 % in France; 34 % in Spain; 43.5 % in the Netherlands; 45–55 % in Austria, Belgium, Germany, and Italy; only 9.9 % for the United Kingdom; and less than 5 % for both the New York Stock Exchange and NASDAQ. Demirag and Serter (2003) estimate the mean of the largest voting block of Turkish listed companies at 45.1 %. It appears that the English speaking countries such as the US and the UK see the smallest voting bloc in companies listed in these countries. As discussed in chapter 1.2 above, the “market-oriented” corporate governance system is more common in the US and the UK where capital market plays a significant role in the economy and institutions have substantial holdings in listed companies. On the other hand, in Continental Europe and Japan it is the “bank oriented” system that prevails (Banker and Charnes, 1984).

ROE (Return on Equity) has been used in this research study to measure corporate performance. ROE is defined as the ratio of net income before tax to the shareholders’ equity. This dependent variable is measured over an annual period.

The basic estimating equation is as follows:

\[
ROE_{it} = \beta_1 + \alpha_1 L_{1it} + \alpha_2 L_{2it} + \alpha_3 L_{3it} + \alpha_4 L_{4it} + \beta_1 K_{1it} + \beta_2 K_{2it} + \beta_3 K_{3it} + \delta_i + \epsilon_{it}
\]  (2)
Where $ROE_{it}$ stands for the ROE of firm $i$ in year $t$ and $L_{it}$ represent alternative measures of ownership concentration in select alternative specifications.

Where

$L1 = \text{the proportion of shares owned by the largest shareholder}$

$L2 = \text{the aggregate shareholdings of the two largest shareholders.}$

$L3 = \text{the aggregate shareholdings of the three largest shareholdings}$

$K1 = \text{shareholdings of the first largest shareholder}$

$K2 = \text{shareholdings of the second largest shareholder}$

$K3 = \text{shareholdings of the third shareholder}$

$\alpha_1, \alpha_2, \alpha_3, \alpha_4, \alpha_5, \beta_2, \beta_3, \beta_4$ are called regression coefficients

$\beta_1$, and $\delta$ are called the error terms, disturbance terms, or noise. These variables capture all other factors which influence the dependent variable $ROE$ other than the regressors.

Based on the regression used by Earle et al (2005), in some cases, $L_{it}$ represents a vector of variables (for instance, ownership by each shareholder separately: $K1_{it}$, $K2_{it}$, $K3_{it}$), and in others the relationship is permitted to be nonlinear and non-monotonic.

Table 4.3 below shows the coefficients derived under two different specifications by using the regression equation for prediction of performance as well as the derived coefficients under four different concentration groups ($L1$, $L2$, $L3$, and $L4$).
<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>.115</td>
<td>.007</td>
<td>16.648</td>
</tr>
<tr>
<td></td>
<td>L1</td>
<td>.525</td>
<td>.257</td>
<td>2.041</td>
</tr>
<tr>
<td></td>
<td>L2</td>
<td>-1.019</td>
<td>.385</td>
<td>-2.646</td>
</tr>
<tr>
<td></td>
<td>L3</td>
<td>.363</td>
<td>.146</td>
<td>2.489</td>
</tr>
<tr>
<td></td>
<td>L4</td>
<td>.629</td>
<td>.292</td>
<td>2.153</td>
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<td></td>
<td>K2</td>
<td>.266</td>
<td>.099</td>
<td>2.683</td>
</tr>
<tr>
<td></td>
<td>K3</td>
<td>.239</td>
<td>.113</td>
<td>2.117</td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROE

Table 4.3: Coefficients for L1, L2, L3, K2 and K3

Based on Table 4.3 above, the Beta coefficients of all the independent variables of L1, L2, L3, L4, K2 and K3 respectively are all less than 0.05 ($p<0.05$), this implies that ownership concentration is significant to ROE, hence to firm performance.

These findings appear to provide concrete evidence that ownership concentration seems to have a positive effect on firm performance. The inclusion of additional shareholders reduces the concentration ratio but does not change the prediction result.
The results remain qualitatively unchanged whether the controls are dropped or not as the test clearly supports the use of fixed rather than random effects. These findings, however, are not in accordance with the overall view that shareholders can create coalitions with ease for monitoring management in an effective way. While it is obvious that ownership concentration has a positive impact on a firm’s performance, the regression is unable to predict how other shareholder groups will react under different situations. This however goes beyond quantitative analysis as likeminded shareholders, if coming together, will form a formidable controlling bloc. On the other hand, if additional shareholders who hold a different stance from the leading shareholder, especially when the latter does not have a controlling stake, group together the concentration ratio indeed decreases.

A positive effect is identified between ownership concentration and corporate performance. In essence, a reduction in the approximated effect could happen since firm performance may be reduced by the addition of extra shareholders. It could well be that adding extra shareholders create interference with the measure of concentration that tends to diminish its coefficient as well as increase the standard error. That the standard error remains stable is an indication that extra shareholders will only create a negative impact on performance.

Furthermore, to provide more support on this statement, the ownerships of the top three shareholders are disaggregated with each individual shareholding being added in the equations separately. Table 4.3 shows an interesting finding of a large but negative coefficient for $L2$, but a positive coefficient for $L3$. $L2$ is the sum of shares held by the largest and the second largest shareholder. That $L2$ is negative may be interpreted that the largest shareholder does not have a majority control situation or need the collaboration of the second largest shareholder to advance his interests. In this regard,
his/her objective may not be in the best interest of the firm and possible at the expense of other shareholders. Accordingly, the concerted efforts of the two largest shareholders may decrease firm performance. On the other hand the fact that \( L3 \), which represents the sum of shares held by the three largest shareholders, is positive suggested that the three largest shareholders need to come together. Collusion among three or more unconnected individual shareholders is practically difficult. Therefore, if they come together, the motive could probably be positive to the firm. It may as well happen that, where these additional shareholders hold relatively significant shareholdings, their existence, albeit passive, will actually lower market liquidity of the entity’s shares. Lower liquidity usually commands less investor attention and widens the information gap. A firm with confronting shareholders will be reflected by a discount to its share price versus industry average. On the other hand, a higher dispersed shareholding structure may also increase the cost of a takeover if the leading shareholder does not have majority control. Notwithstanding this, where the biggest shareholder is exceptionally large Zwiebel (1995) indicates a possibility that concentration may function differently as opposed to when it is less dominant.

There is no general pattern for predicting whether the largest shareholders will act in harmony or against one another. If they align together, they are sure to reduce market liquidity. One the other hand, if they should act against one another, a deadlock may occur, thus creating an opportunity for management to take effective control or, in the negative case, rendering management immobility.

Again, if the largest shareholder does not have a majority stake then perhaps it can be argued that the additional shareholders would help monitor management performance. The largest shareholder, due to its weak shareholding position, will not soak up the firm’s share liquidity. Zwiebel (1995) describes a powerful shareholder
dominating ownership as “creating its own space,” and calls it “forming coalition” where several smaller, non-controlling, shareholders come together.

To test this hypothesis on Chinese listed companies, the regression equation is re-estimated in a linear form, with the inclusion of both $L1$ and $L4$, being the sum of all other shareholders, and interacting both of these variables. Zwiebel(1995) argues that additional shareholders add value below the threshold, while above it they may have a negligible influence or lower the value. The estimating equation is re-presented as follows:

$$ ROE_{it} = \beta_1 + \alpha_1 L_{1t} + \alpha_2 L_{2t} + \alpha_3 L_{3t} + \alpha_4 L_{4t} + \beta_2 K_{1t} + \beta_3 K_{2t} + \beta_4 K_{3t} + \delta_{it} \quad (2) $$

The results seem to be consistent with the general view and indicate that Zwiebel’s prediction also works on Chinese listed companies. When $L1 > 50$, which means there is one very large shareholder, the addition of additional shareholders may create more interference than reduce market liquidity. In other words, they do not necessarily come together. However, on the other hand, the data provide little support on the second view of Zwebel, which is that smaller shareholders will form a coalition in the absence of a large shareholder. This implies that they fail to act in concert to take majority control to exert influence on and control management. Firm performance is therefore arguably not been improved with or without the presence of a dominant shareholder.

In evaluating the robustness of the results, a number of different specifications are approximated. For example, some of the controls may be dropped from the regressions such as the year effects, the lagged value of performance, and all of these variables. Furthermore, the regression equations will need to be re-estimated. Lagged
concentration measures are defined as the average over year’s $t-2$ and $t-1$. Strikingly, in most cases, the findings remain quite consistent. All findings point to support the view that only the largest shareholder with a dominant shareholding has a major and positive impact on all performance measures.

Extending the analysis to studying the effect of ownership concentration by shareholder types does not reveal a different pattern, whether the shareholder background is foreign or domestic. The only similarity among different shareholder types is in the pattern of coefficients. Lagged concentration is found to be of a lower value where ROE is adopted as the dependent variables. These inconsistent findings give no clear prediction as to which type of shareholders is better, in the context of Chinese listed companies. Hence it may be argued that it is the ownership structure that matters more on firm performance and not the type of shareholders (He et al, 2013). As the size of the largest shareholder’s shareholding increase, firm performance also tends to increase.

Bolton and Von Thadden (1988) propose a model that is meant to show that concentration of ownership in the hands of the largest shareholder will reduce market liquidity of the firm’s shares. Study by Demesetz (1968) and Becht (1999) using firms in United States and Germany report supporting evidence on this prediction.

Further tests have been conducted to seek other proof that it is the leading shareholder’s shareholding that will improve performance. To test this hypothesis, the same equation is re-estimated, using annual share turnover. Annual share turnover is defined as the volume of shares traded in a year divided by the average number of shares outstanding. This ratio can be used as a proxy for share liquidity showing how
many times the shares have changed hands. A higher ratio means higher market liquidity. However, higher concentration of shareholdings in the hands of the largest shareholder will decrease liquidity (Mousa and Desoky, 2012). It also implies that a higher shareholding of the other leading shareholders indeed has more impact on liquidity than the largest shareholder. When concentration exceeds a certain threshold, the concentration effect will have a negative impact on market liquidity irrespective of whether or not the shareholdings are concentrated in the hands of the largest shareholder or the other shareholders. This leads to another research topic on whether there is an optimal threshold shareholding.

It should be noted that the concept of institutional investors is still nascent in China. There are very few cases, if any, where a Chinese listed company is majority controlled by or having an institutional investor as the largest shareholder. Therefore, in most cases, concentration of shareholding may occur among the government and other government-owned entities or institutions with the government being the largest shareholders. Another related area of research interest will be the mutual effect of the change in relative shareholdings between the largest government shareholder and other large, non-government shareholders on firm performance.

Another major concern is about insiders against outsiders. Arguably, if the leading shareholder through its dominant shareholding controls management of the firm then it may be expected that firm performance may improve in terms of reducing agency costs that may arise between the owner and the manager of a firm. Yet the findings do not appear to lend any support to this argument. It may be argued that the negative impact of additional shareholding beyond a certain threshold may surpass the benefits of lower agency costs.
Morck, Shleifer, and Vishny (1988) argue that ownership concentration has its costs as well as benefits. Whether the cost and benefits will set off each other or what the net effect will be and how to measure it is an interesting topic for further study. The net effect may be a function of the level of ownership concentration or a function of the threshold level. The implication is that the correlation could be non-linear. It is also worthy of further study the effect of dispersed concentration, meaning several shareholders coming together, and a collaboration of a few largest shareholders, on firm performance. In this regard, in the context of this research study and based on the findings, it appears that shareholding concentration in the hands of a single largest shareholder is positively related to firm performance and that ownership concentration by shareholders other than the single largest shareholder has no significant impact, or even a negative impact, on firm performance (Mousa and Desoky, 2012). The findings also fail to provide any support of a monotonicity as it relates to the impact of ownership concentration on firm performance.

Although related literature is prolific, no conclusive consensus seem to have been reached in the academia and business world as to which specific model is the best in terms of best corporate governance with respect to ownership concentration. This issue is even more complicated in the context of China due to its unique socio-political system. In essence, China is moving further down the road towards market economy. Even in the global context, it still cannot be concluded that firms with dispersed ownership necessarily perform better than firms with a controlling shareholder. The effect ownership concentration on firm performance may hold true only within a range. Yet this general view is also susceptible to the interactive behaviors of different shareholder groups of a firm. It has long been argued that a firm with a dominant shareholder is more vulnerable to the risk of smaller investors’ rights being expropriated
(Shieifer and Vishnym 1997; Dahya and Dimitrov, 2005). On the other hand, management is also enticed to introduce more investors so to disperse ownership to create more space for them to manipulate operations or even devise plans to maximize their own benefits. The interactive effect of the various factors such as level of concentration, concentration threshold, degree of disperse of shareholdings etc. warrant further empirical studies. In a big developing economy like China’s these issues seem too far-fetched. The findings in this research study, however, do indicate that listed firms in China seem to follow the general pattern that has been identified in the West. Perhaps it is fair to say that the gist is in the mindset of the controlling shareholder and the management. It may be argued that if there is a right cause, regardless of the form of ownership structure it will still lead to positive firm performance. This being said, developments in corporate social responsibility and corporate governance, coupled with improved regulatory frameworks have significantly improved governance and public awareness that in turn translate into a monitoring tool on corporate management.

4.3 Corporate Performance With Respect to CEO Characteristics

In this section, the relationship between CEO characteristics and corporate performance of the China listed firms will be investigated for the period from 2010 to 2013. The objective is to identify the financial effects of the various CEO characteristics on firm performance.

The relevant research question regarding CEO characteristics has been described in chapter three above and recapped as follows: Are CEO characteristics significantly associated with the performance of Chinese listed company?
To find an answer to this question, a regression equation has been developed to find out the relationship between CEO characteristics and the performance of Chinese listed companies.

\[
ROE_{it} \equiv \beta + \alpha_1 CEO\_AGE_{it} + \alpha_2 CEO\_SEX_{it} + \alpha_3 CEO\_EXP_{it} + \alpha_4 CEO\_QUAL_{it} + \alpha_5 CEO\_APP_{it} + \delta
\]  

(3)

Where \( ROE_{it} \) stands for the ROE of firm \( i \) in year \( t \)

Where

\( ROE = \) Return on Equity

\( CEO\_AGE = \) Age of CEO

\( CEO\_SEX = \) Gender of CEO

\( CEO\_EXP = \) Experience of CEO

\( CEO\_QUAL = \) Education level of CEO

\( CEO\_APP = \) Family Member of big Shareholder.

\( \alpha_1, \alpha_2, \alpha_3, \alpha_4, \alpha_5, \beta_2, \beta_3, \beta_4 \) are called regression coefficients

\( \beta \) and \( \delta \) are called the error terms, disturbance terms, or noise. These variables capture all other factors which influence the dependent variable \( ROE \) other than the regressors.
In order to find an answer for this research question the following hypotheses will be tested:

Hypothesis 7: The performance of Chinese listed companies is positively associated with the age of the CEO

Hypothesis 8: The performance of Chinese listed companies is positively associated with the gender of the CEO

Hypothesis 9: The performance of Chinese listed companies is positively associated with the experience of the CEO

Hypothesis 10: The performance of Chinese listed companies is positively associated with the qualification of the CEO

Hypothesis 11: The performance of Chinese listed companies is positively associated with the internal CEO appointment, represented in the form of a family member of the largest shareholder.

For purposes of this research, five independent variables have been determined:

1) Age of CEO

2) Gender of CEO

3) Experience of CEO

4) Education level of CEO

5) Internal Appointment (Family member of the controlling shareholder).
It is argued that these variables reflect the current CEO characteristics in China.

The dependent variable is “firm value” which is reflected by the performance of a firm. Performance is measured by Return on Equity (ROE). Where:

\[
\text{ROE} = \frac{\text{PBDIT}}{\text{EC}}
\]  \hspace{1cm} (1)

EC = Equity Capital

The major reason for selecting ROE as the accounting variable is that it maintains a straight relationship with a firm's performance.

In this section, the correlation method has been selected to find out the relationship between CEO characteristics and corporate performance.

**Hypothesis 7 testing**

Hypothesis 7 is about the relationship between "Age of the CEO" and firm performance. It is hypothesized that the more mature a CEO is the better capability he/she will possess. In this testing, different aged groups are established at 5-year intervals. Different values are assigned to the various groups.
Age Groups

1 for 20-30
2 for 31-40
3 for 41-50
4 for 51-60
5 for 60 above

Results of the testing are listed out in table 4.4 (a) (b) below.

<table>
<thead>
<tr>
<th></th>
<th>ROE</th>
<th>AGE</th>
<th>GENDER</th>
<th>EXPER</th>
<th>QUAL</th>
<th>FAMILY</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ROE</strong> Pearson Correlation</td>
<td>1</td>
<td>.413**</td>
<td>.385**</td>
<td>.521**</td>
<td>.604**</td>
<td>.472**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
</tr>
<tr>
<td><strong>AGE</strong> Pearson Correlation</td>
<td>.413**</td>
<td>1</td>
<td>.033</td>
<td>.170</td>
<td>.053</td>
<td>.121</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.308</td>
<td>.072</td>
<td>.578</td>
<td>.200</td>
<td>.300</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
</tr>
<tr>
<td><strong>GENDER</strong> Pearson Correlation</td>
<td>.385**</td>
<td>.033</td>
<td>1</td>
<td>.019</td>
<td>.085</td>
<td>.033</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.308</td>
<td>.842</td>
<td>.372</td>
<td>.308</td>
<td>.308</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
</tr>
<tr>
<td><strong>EXPER</strong> Pearson Correlation</td>
<td>.521**</td>
<td>.170</td>
<td>.019</td>
<td>1</td>
<td>.049</td>
<td>.301**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.072</td>
<td>.842</td>
<td>.604</td>
<td>.001</td>
<td>.001</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
</tr>
<tr>
<td><strong>QUAL</strong> Pearson Correlation</td>
<td>.604**</td>
<td>.053</td>
<td>.085</td>
<td>.049</td>
<td>1</td>
<td>.121</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.578</td>
<td>.372</td>
<td>.604</td>
<td>.200</td>
<td>.200</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
</tr>
</tbody>
</table>
Table 4.4(a) Correlation between CEO characteristics and ROE

<table>
<thead>
<tr>
<th>FAMILY</th>
<th>Pearson Correlation</th>
<th>.472**</th>
<th>.121</th>
<th>.033</th>
<th>.301**</th>
<th>.121</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.000</td>
<td>.200</td>
<td>.308</td>
<td>.001</td>
<td>.200</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
<td>948</td>
</tr>
</tbody>
</table>

* Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).

### Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGE</td>
<td>3.46</td>
<td>.914</td>
<td>948</td>
</tr>
<tr>
<td>GENDER</td>
<td>1.12</td>
<td>.328</td>
<td>948</td>
</tr>
<tr>
<td>EXPER</td>
<td>3.65</td>
<td>.923</td>
<td>948</td>
</tr>
<tr>
<td>QUAL</td>
<td>3.64</td>
<td>.954</td>
<td>948</td>
</tr>
<tr>
<td>FAMILY</td>
<td>3.45</td>
<td>1.003</td>
<td>948</td>
</tr>
</tbody>
</table>
# Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.300&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.090</td>
<td>.085</td>
<td>.660</td>
</tr>
</tbody>
</table>

<sup>a</sup> Predictors: (Constant), FAMILY, GENDER, AGE, QUAL, EXPER

## Coefficients<sup>a</sup>

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>2.854</td>
<td>.132</td>
<td>21.677</td>
</tr>
<tr>
<td></td>
<td>AGE</td>
<td>.102</td>
<td>.033</td>
<td>-.003</td>
</tr>
<tr>
<td></td>
<td>GENDER</td>
<td>.090</td>
<td>.066</td>
<td>.043</td>
</tr>
<tr>
<td></td>
<td>EXPER</td>
<td>.130</td>
<td>.032</td>
<td>.174</td>
</tr>
<tr>
<td></td>
<td>QUAL</td>
<td>.072</td>
<td>.028</td>
<td>.100</td>
</tr>
</tbody>
</table>

144
Correlation makes no a priori assumption as to whether one variable is dependent on the other(s) and is not concerned with the relationship among variables; instead it gives an estimate as to the degree of association between the variables. It tests for interdependence of the variables.

From table 4.4(a) above, the correlation coefficient is found to be 0.4131 with p<0.05. This means that the correlation between ROE and AGE is positive and significant, thus demonstrating that there is a positive relationship between the age of the CEO and firm performance. It can therefore be inferred that the higher the age of the CEO, the stronger a listed firm's performance is. **Hypothesis 7: “The performance of Chinese listed companies is positively related with the age of the CEO” is thus accepted.**

As regression attempts to describe the dependence of a variable on one (or more) explanatory variables; it implicitly assumes that there is a one-way causal effect from the explanatory variable(s) to the response variable, regardless of whether the path of effect is direct or indirect.
The finding that the age of CEO and firm performance are significantly and positively related can be explained on reasons of maturity. Presumably the more mature a CEO is, the more informed decision he/she is inclined to make. Mature executives tend to avoid making hasty and impromptus decisions. It may be argued that this may be at the expense potential profits as slow reaction to rapidly changing business environments may see good business opportunities go by due to indecision. However, this is at best a guess as there is no effective means to measure potential lost business opportunities in a statistical sense. In the corporate context the risk of a wrong business decision could be way more expensive than the potential profit from a foregone business opportunity.

Hypothesis 8 is about the relationship between the gender of the CEO and firm performance. A similar approach is adopted for the testing. A value of “1” is assigned to “Male” and “2” to “Female”. The results of the testing are listed out in Table 4.4 above.

The correlation coefficient is positive and significant (at $\alpha = 0.5$). Accordingly, it can be concluded that there is a positive relationship between gender and firm performance. Therefore, Hypothesis 8: “The performance of Chinese listed companies is positively related with the gender of the CEO” is accepted.

Hypothesis 9 is about the relationship between the experience of the CEO and firm performance. Using a similar approach as in testing the other hypotheses, the test is meant to find out the possible correlations between the independent variable of “experience” and the dependent variable of “firm performance”. For purpose of testing,
difference levels of experiences are established with 5-year intervals. Different values are assigned to each level of experience.

**Experience**

1 for less or 5 years’ experience in senior management post
2 for 6 to 10 years’ experience in senior management post
3 for 11 to 15 years’ experience in senior management post
4 for 16 to 20 years’ experience in senior management post
5 for 21 or above experience in senior management post

It is hypothesized that the quality of decisions made by a CEO will improve as he/she gains more experience in a senior management position. As table 4.4 illustrates, there is a positive and significant correlation coefficient (p<0.05). It may therefore be concluded that there is a positive relationship between the experience of a CEO and firm performance. This is easily understandable for if a CEO accumulates more experience the decisions made by him/her will be more informed thanks to his/her wide business exposure and experience. Good decisions will naturally lead to better corporate performance. Therefore, **Hypothesis 9: “The performance of Chinese listed companies is positively related with the experience of the CEO” is accepted.**

Hypothesis 10 is about the relationship between the qualification of the CEO and firm performance. It is hypothesized that there is a positive relationship between CEO education level and firm performance.
**Education Level**

1. for high school
2. for University/tertiary institution
3. for Master degree holder
4. for Doctorate degree level

From table 4.4 above, it can be seen that the correlation coefficient is 0.604 which is positive and significant (p<0.05). Therefore, it may be concluded that there is a positive relationship between the education level of a CEO and firm performance. Again, this empirical result is easy to be interpreted. The more educated a CEO is, the better the quality of the decisions made by him/her will be. Although good education is not a guarantee to good decisions as business decisions need good business acumen and judgment, by and large a well-educated CEO tends to be able to draw on his/her academic training to consider more issues and in greater detail in making a business decision. Therefore, “Hypothesis 10: The performance of Chinese listed companies is positively related with the qualification of the CEO” is accepted.

Hypothesis 11 is about the relationship between internal appointment, representing being a family member of a big shareholder and corporate performance. For purposes of this testing, different values are assigned to the independent variables. A value of 1 is assigned to “a non-family member” and 2 to “a family member”.

Testing results in table 4.4 show a positive correlation coefficient which is also statistically significant (at α = 0.5). It can therefore be concluded that there is a positive
relationship between the CEO being a family member of a big shareholder and firm performance. The finding is consistent with the agency theory. It can be explained that if the CEO is a family member of a big shareholder, he will tend to safeguard the company’s interest hence the family interest. Therefore, Hypothesis 11: “The performance of Chinese listed companies is positively related with the internal CEO appointment” is accepted.

This study provides empirical evidence concerning the relationship between CEO characteristics and firm performance. It addresses some of the contemporary corporate governance issues. Furthermore, it also provides some hints on the practical criteria for recruitment/appointment of CEOs. Most importantly, it provides some leads on the study of CEO characteristics among China listed firms as they relate to performance.

4.4 Conclusion

This chapter focuses on quantitative testing of the hypotheses to find an answer to the research questions. The aim is to investigate the performance of Chinese listed firms with respect to each of the factors of ownership structure, ownership concentration and CEO characteristics. It is found that in a high-ownership concentration situation there exists a positive and significant relationship with ROE. Furthermore, the finding also supports the presence of a direct relationship that exists between firm performance and institutional ownership. The study also supports the finding that concentrated ownership in the hands of a leading shareholder and among by a high number of minority shareholders can play a significant role towards building good corporate governance among Chinese listed firms.
This research also has shown that CEO characteristics have a positive impact on firm performance. As the Chinese government continues with economic reform and corporatization of SOEs, the role of the CEO will become more important. This implies that previous research studies conducted in the developed economics on this topic will be applicable in the Chinese context as Chinese economy converges with the international markets.
CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

As the Chinese government continues with economic reform, a major sector of the economy that continues to experience transformation towards internationalization is the local stock markets. The securities regulatory watchdog, namely, the China Securities Regulatory Commission is encouraging more Chinese companies to go public and also orderly opening the local securities markets to international investors. The purpose is to enable optimization of financial resources and capital from both the government and private sectors.

As mentioned in the previous chapters, China has adopted a different economic reform path. It is a more restrained, gradual process that aims to focus on reform of enterprise ownership without undergoing political reform. Instead of opting for wholesome privatization of state-owned enterprises, as Russia had done during Yelsin’s times, China has been trying to make use of the local stock exchanges to raise capital to finance corporate development. Accordingly, the Chinese stock markets have been growing steadily, though not without hiccups along the process. This is because the Chinese government is using the old style supervising and monitoring mentality in regulating the activities in the stock market under the premise of maintaining stability. This approach may, on the one hand, be able to maintain short-term stability; it is indeed at the expense of market efficiency. The people would expect the government to intervene whenever heavy market volatilities emerge. Government intervention and manipulation of the stock markets are still common. Accordingly, market imperfection has rendered good corporate governance practice harder to implement.
Since the Chinese government chose to adopt an orderly corporate reform approach, only gradual ownership structure changes have been witnessed. It started with the state-owned enterprises. Because of this gradual process, even after years of economic reforms, the government still maintains significant ownership of state-owned enterprises (Li and Rauthorgasira, 2008). Nevertheless, despite keeping a tight grip on ownership, the government is gradually moving away from dictating day-to-day management and decision making of the SOEs, leading to the so-called “No” phenomenon of ownership (Li and Rauthorgasira, 2008). The rising influence of corporate management on the day to day operations often leads to a potential conflict between management and the government agencies that oversee the state-owned enterprises administratively. This notwithstanding, this trend does reflect the central government’s strategic direction of separating state ownership and management in state-owned enterprise. Accordingly, the role of professional executives, especially the CEO is becoming all the more essential. This will impact on the performance of SOEs while executive power is transitioning to the CEO together with the management team. CEO characteristics will be gaining more significance as the reform proceeds.

It has been shown in previous chapters that ownership structure matters in China. In terms of the economy of China, the main structure of ownership is not always the one which is most efficient. Across China, legal control by a large shareholder, or coalition of shareholders who control the board, is the dominant ownership form (Grant and Kirchmaier, 2004). Worth noting is that while there is a general recognition that less government involvement in a firm would lead to better performance of the firm, in some previous studies, it is found that concentrated government ownership in some cases actually leads to better firm performance. Most studies would conclude that privately owned China listed firms significantly outperform those under state ownership. This phenomenon can be explained by the fact that, barring government intervention, private enterprises will be fully profit oriented and will seek to undertake business opportunities.
that offer the best economic returns. It also follows that with a decent economic return, these firms will have better share price performance which in turn helps the firm raise capital in the stock markets.

It may be argued that the relatively better performance of the Chinese firms with dispersed ownership could be a result of the fundamental changes that having been undergoing in the Chinese capital markets. As the capital markets continue to develop, market liquidity also increase, especially after the stock reform in 2005 that comes with stricter disclosure requirements, increased information flows and improved legal protection of minority shareholders (Grant and Kirchmaier, 2004). All these developments have allowed more market liquidity a result of which is the value of the firm is thus maximized as investors can buy and sell shares readily. All shareholders in a transparent market will reap benefits as investors re-rate the trading stocks with premiums - a positive result of simplified control structures (Shinn and Gourevitch, 2002). Increased liquidity, lower cost of capital, and risk adjusted returns, are some of the benefits pointed out by Shinn and Gourevitch (2002). These benefits are reflected in the price premium.

In this research study, it is found that there exists a significant positive relationship between the performance of a firm and government ownership. The results contradict the findings of Demsetz and Lehn (1985) who argue that different ownership structures are all consistent with the corporate objective of value maximization, and therefore systematic differences may not be observed between ownership and performance.
The result obtained from this research study contradicts the findings in most of the literature for other economies. According to these findings, government shareholding should have an overall positive impact on firms in China. However, given the co-existence of mixed ownership enterprises in China, the relationship between corporate performances and ownership structure is not a simple linear relationship. The adverse effects of concentrated state ownership are not monotonous. It is argued that management efficiency may be compromised when managers have to balance between the uprising number of large private shareholder groups and the decreasing yet still significant state ownership.

Although the Chinese government continues its efforts to reform the corporate sector, especially the SOEs towards the direction to separate ownership and management, many chairmen and CEOs of the SOEs are still appointed by or are government officials. They have a tendency to protect or propel expansion of the SOE under their management using their political might and influence to gain access to precious tangible or intangible resources, at the expense of other non-state owned enterprises. The various levels of governments that own the SOEs are also inclined to protect and favor the SOEs which are usually vital to the economy of which they are a part. From this perspective, it may be argued that a concentrated ownership structure is beneficial to the enterprise. The benefits of ownership concentration of a SOE are obvious. In the context of a private enterprise, entrepreneurial spirit sometimes can better be unleashed under a concentrated ownership in which the owner/entrepreneur uses his charm and market intuition to identify and secure opportunities for the firm he owns without having to consider other shareholders. This partly explains why successful private enterprises in China usually have a very lean and mean structure and tight budget control during the start-up stage.
The findings in this research study also contradict the results of a research by Zingales and Rajan (2003) who oppose concentrated ownership. They opine that firms with dispersed ownership are more efficient and stand to create more opportunities across any markets and societies. This type of firms will also garner more political support for decisions that are market based. They argue that firms controlled by heirs who inherited the business from their predecessors tend to perform below industry average and are less inclined to commit to research and development expenditures. They are against inheritance and take the view that the legal and tax regime should be designed to discourage succession and inheritance and encourage the rich to only pass on productive assets to their heirs instead of active control of the family business. Villalonga and Amit (2004) opine that firm value is actually destroyed when a firm is passed on to the heir. Zingales and Rajan (2003) seem to recognize that dispersed ownership is still not the unilateral dominant structure but firmly believe that ultimately firms with dispersed ownership will excel in the market place. This indeed brings out a long debated issue of which form of ownership is the undisputed excellent model. In the past decade, entrepreneurial spirit has seen many technology based companies spring up. Their success formula is entrepreneurship and innovation. Invariably these firms have a very clear corporate philosophy and culture that reflect the owner cum manager of the firm. Entrepreneurs are invariably the controlling shareholders of the firm they set up and own. Interestingly, more and more literature considers these innovative and progressive private enterprises as the momentum of the future business world.

The confusing findings from different studies done at different periods can be explained by the fact that that the measured performance of firms having concentrated government ownership is not purely based on economic grounds. It might be having something to do with the policy favor that these majority government enterprises enjoy. In other words, some direct or indirect subsidies may help reduce operating costs or
provide a source of non-operating revenue. This distorted scenario is unique to China as China has not employed a wholesome privatization approach in reforming the economic structure. When pure economic forces come into play, Chinese enterprises do follow the performance pattern that prevails in other developed market economies across the world. This helps explain why there is a U-shaped performance pattern relative to different levels of concentration of ownership (Sun and Huang, 1999 and Tang, 2006).

It may be argued that the existing ownership structures of China listed firms are the interactive outcome of a host of historical and socio-political factors coming into play at the same time. Apparently issues in the western context such as institutional investors, tax and law codes, ownership concentration, government and private ownership etc. are also applicable in China. The literature quoted in this research study, however, may not necessarily be applicable to China. It however provides a good theoretical and empirical ground on which to study corporate governance and firm performance from a practical perspective. Repeating a model empirically tested in the western context on Chinese firms may lead to new insights. The vast amount of literature and models developed are a culmination of the collective wisdom of numerous academics and business practitioners over many years and will be invaluable to China when formulating her own economic policy. They become an easy reference as China continues to follow its own unique reform path, reflected by the deregulating of the state’s control over the operations of state-owned enterprises. The government is making strenuous efforts to further liberalize and promote the local stock exchanges and encourage state-owned enterprises to further tap the domestic and international capital markets. Furthermore, subtly going on is a policy push to procure those mammoth state-owned enterprises to unload non-core assets to focus back on their task based core activities. The policy should not be regarded as a proxy for privatization but rather a refocus on an enterprise’s core competencies. The state still maintains a significant ownership in the key SOEs for strategic and national security reasons. Thus, this policy
move should be viewed as one of specialization than privatization. This enterprise reform approach differentiates China from other countries that go for wholesome privatization that usually comes with change of the regime.

Another aim of this research study is the investigation of the relationship between ownership structures and firm performance. It is found that in a high-ownership concentration situation, there exists a positive and significant relationship with ROE. Furthermore, the findings also support the presence of a direct relationship that exists between firm performance and institutional ownership. The findings also reveal that concentrated ownership of equity by leading shareholders and by a high number of minority shareholders can play a significant role towards establishing good corporate governance in Chinese listed companies, where the protection of shareholders is still not appropriately established.

Tests conducted in this research study have returned findings that are mostly in line with those conducted in other economies previously. It may be inferred that economic rules also prevail even in a different political system like China’s. It has been shown that concentration of shareholding in the hands of a large shareholder has a positive impact on firm performance (Mousa and Desoky, 2012), within certain boundaries. Identifying and determining these boundaries can be a separate area of future research study.

In the case of SOEs in China, the managers may have dual tasks. One task is to pursue maximum profit for the firm. In this regard, there are instances where SOEs take advantage of its dominant economic power to deprive other private enterprises of access to resources and even exert pressure on lower level local governments to make
concessions for them. Another task of the SOEs is to fulfill its political mission of exploring and developing certain industries that are vital to the state. When politics comes into play, these SOEs and their management may not be able to play by pure economic rules. In a populous country as China is where resources are sought after by a great many enterprises, concentration of ownership in the hands of the government may be argued as one way of achieving economic and corporate efficiency, as long as these SOEs abide by the law and market rules and are run by capable managers. It is also interesting to note that a SOE differs from a family controlled enterprise in that although the state is the sole owner of a SOE, the managers are just agents of the state. They themselves do not own the majority shareholding. Therefore, watching from perspectives, SOEs seem like a firm with concentrated ownership whose management is entrusted to professional managers to run the operations. From this angle, it is worth noting that the same agency problems commonly seen in big corporates with dispersed ownerships where the managers try to maximize personal benefits at the expense of shareholders could as well occur among the SOEs.

Based on the findings in this research study, it may be argued that development of stock markets in China does not necessarily have to have a direct link with advancement of corporate governance though this is one of the objectives and missions of the regulators. From a corporate governance point of view, the selling of non-tradable shares by SOEs to domestic investors has little, if any, bearing on corporate governance. It has been shown that institutional investors play a critical role in monitoring corporate management hence are conducive to advancing corporate governance. Public shareholders simply lack the financial and other resources and incentives to monitor the acts of management. This view is echoed by Tenev and Zhang (2002).
This research study has shown that CEO characteristics have a positive impact on firm performance. At a time when the Chinese government is pushing for more specific and focused enterprise reform, more notably on state-owned enterprises, the role of the CEO will only become more critical with each day. Despite the differentiated approach adopted by the Chinese government on reform, in reality the economy is moving towards convergence with international practice. Giving the rising importance of the CEO role in a corporate, and the gradual transition of executive decision making power to the CEO, there will be a stronger need to exercise more stringent scrutiny of the virtues of the CEO while at the same time offering a decent incentives and remuneration package for the CEO.

The results from this research study are attributed to various implications. There seems to be significant variations in usual observable characteristics such as age, experience and education. These measurable managerial virtues are the management talents that CEOs are expected to possess. The findings are also consistent with the general view on CEO characteristics. Thus it is not surprising to identify a positive relationship between various CEO characteristics and the performance of Chinese listed firms. In general, CEOs of listed firms in China demonstrate a similar performance mode as their overseas counterparts. It is also consistent with the general assumptions used in different theories such as those adopted by Rosen (1981). Among the various characteristics, it is found that firm performance has a stronger correlation with the experience and education of the CEO. Again this finding is also consistent with the various theories.

Other studies on CEO characteristics touch on such characteristics as managerial confidence and resoluteness (Malmendier and Tate, 2005; Gervais et al, 2008; Graham et al, 2009). However, in the context of China, these characteristics are practically not
easy to be measured. Whether an outsider CEO is more successful than an incumbent CEO is suggestive, as in the prediction of Murphy and Zabonjik (2004). The practical limitation of comparing the virtue of identifying a CEO by internal appointment or from outside candidates in China is that most of the CEOs of SOEs are appointed by the government. It is very rare to see a SOE recruit a CEO by open recruitment from outsiders. Therefore, any comparison can only be conducted in private enterprises thus rendering the study incomplete. Even among the academics, some are proponents of outside recruitment while some like Khurana (2002) would prefer insiders to outsiders. In China, some local level SOEs in the non-sensitive sectors have been seen to start recruiting outsiders to take up senior positions. The fact that almost all CEOs of large SOEs are appointed by the government or through internal appointment is not surprising. Apart from political and institutional reasons, few outsiders would have matching experience with the state appointees who have the advantage of accumulating high level experience with the SOEs in their entire career.

In conducting this study, several limitations have been encountered. Despite having a forward and prospective research topic on CEO characteristics, the outcome of the measures may be subjective and coarse. This study has failed to provide a formal solution to concerns regarding endogenous similarity of firms and candidates. Finally, the results reflect only as much as the companies adopted in this study. The sample of companies, though as representative as it could have been in the context of China, may be not big enough to be representative. The generality of the research study findings remains an empirical question open to further study. Again the familiarity of the research study findings and the opinions suggested by Drucker (1967) targeting a large number of firms that include private, public, small, large and non-profit indicates that the results of this research study hold broadly.
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183


