

OWNERSHIP STRUCTURE AND FIRM PERFORMANCE IN EMERGING MARKETS: EVIDENCE FROM CHINESE LISTED FIRMS

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Abstract

This study investigates how ownership structure impacts on the corporate performance of listed firms in China. The study uses sample data of firms listed in the Shanghai and Shenzhen stock exchanges for the five year fiscal period that ended 2005. The results of the panel data regression analysis suggests firm performance to have positive and significant relation with the proportion of shares held by the institution, through the legal person holding companies. In addition, while state ownership indicates negative influence on performance, individual and foreign investors are found to have positive effect on performance, though at a minimal levels. Interestingly, the effect of ownership structure is stronger in firms experiencing the dominance of legal person share holdings over state shares. Further, firm size and ratio of debt to equity are also observed to have influence on the performance of Chinese listed firms. These findings are of great significant to policymakers, academics, shareholders and other stakeholders.

Keywords: Ownership structure, Firm performance, Chinese listed firms, Shareholders, Corporate governance

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Introduction

Since the work of Jensen and Meckling, (1976), corporate governance has been widely studied in an effort to mitigate the agency problem, resulting from the separation of ownership and control. Emerging markets face serious agency problem, as a consequence to poor governance stemming from weak legal and other institutional systems. Ownership structure has been recognized as a control mechanism in monitoring the activities of the firm (Shleifer and Vishny, 1986). A number of researchers have demonstrated evidence, though largely from the matured economies, on the significant of ownership structure to the value of the firm (McConnell and Servaes, 1990; Grossman and Hart, 1980). However, the issue as to how ownership structures impact the performance of firms in emerging markets such as China, a country with a unique institutional framework, still remains a challenge that beckons for attention. The need to investigate the impact of ownership structure of Chinese listed firms is imperative, considering the significant influence of the Chinese economy on the global economy. Understanding how ownership structures impact on Chinese firms would assist policymakers, investors and other stakeholders in making informed decisions. Since the official opening of China to the outside world in the late 1970s, the country has undergone

massive economic reform, leading to consistent double digit GDP growth in recent years. Prior to the restructuring of state-owned enterprises (SOEs), virtually all Chinese enterprises were hampered by gross inefficiency, perhaps stemming from the overbearing influence of the state on the activities of these firms. Soon after, and without radical changes in ownership structure, China began the process of reforming the SOEs towards a market-oriented system. Under this philosophy the state began transforming SOEs from loss-making cost centers into profitable, return-oriented investment centers organised on competitive-market principles encompassing both the manufacture of products and acquisition of the required factors of production (Rawski, 1994). The approach adopted by China in the reform of SOEs, is a departure from the ownership-privatization approach widely adopted in Russia and other parts of Eastern Europe (Rawski, 1994 and Boycko et al., 1996).

Although the market-oriented approach, as adopted by the Chinese Government, has helped in fostering economic growth, the system has failed to show any signs of enhanced efficiency, and thus an improvement in the overall performance of the SOEs. Their poor performance was conceivably due to their prior ownership structure, which may have resulted in managers lacking the authority to properly govern their company described as the agency problem

(Jensen and Meckling, 1976; Xu and Wang, 1999). Managers in Chinese listed firms enjoy control of only a small fraction of the companies' shares. Laws require share ownership to be concentrated in the hands of legal persons defined as domestic institutions, state and domestic individuals or institutions. As part of the new requirements to list on the stock exchange, managers of state-owned listed companies now possess autonomy in decision making, with regard to the activities of the firm. Although this has delivered some improvement agency problems persist, and these stem from the separation of ownership and control. The question remains of how to deal with the present agency problem in firms where the state retains a significant interest? A solution is urgently needed that will support managers power to act in the best interests of the state and other stakeholders as well.

In the current study, the effects of agency problems are investigated by using firm performance as the dependent variable influenced by a variety of ownership structures thought to embody differing levels of agency problems. Chinese firms listed in the Shanghai and Shenzhen stock exchanges form our research sample as we closely examine the effect of the proportion of shares held by the legal persons and state shareholders on firm performance. In our study, we hypothesize that ownership structure has an impact on the performance of Chinese listed firms. We focus our study on this aspect of corporate governance because of the significant effect the proportion of shares held by each category of shareholder could have in the external monitoring and control of listed firms. Our study contributes to the growing governance literature, which argues that ownership structure has a significant influence on firm performance (Denis and McConnell, 2003; Jensen and Meckling, 1976). Specifically, we employ panel data that controls for firm specific unobserved heterogeneity and aggregate macroeconomic shocks. In the investigation, we found ownership structure, concentrated in the hands of legal person, state and domestic individuals or institutions, to have a significant impact on firm performance measures such as return on equity, Tobin Q and return on assets.

The ownership structures of listed firms in China have some unique characteristics. This might stem from the fact that most listed companies are re-structured stated owned enterprises (SOEs). Chinese shares are categorized into two broad groups that is, the A-shares, which are the domestic shares for domestic or institutional investors and the B, H and N shares, for the offshore investors. The A-shares are further divided into legal-person shares, State shares, tradable A-shares and employees shares. The legal person shares are those held by any domestic entity or institution with a legal person status, including an SOE or a firm controlled by an SOE. State shares are held by agencies or institutions authorized to hold such shares on behalf of the state or local government. While the tradable A-shares are held and traded

mostly by domestic individuals or institutional investors, the employees' shares are those held by employees of listed firms. The employees' shares are usually offered at a discount to the employees. The B, H and N- shares are exclusively held by offshore investors. In China, the market for B, H and N-shares are different from A-shares. While the Shanghai stock exchange B-share is denominated in U.S. dollars, the Shenzhen stock exchange B-share is denominated in Hong Kong dollars. The H-shares are listed and traded in the Hong Kong stock exchange market and N-shares are listed and traded in the New York stock market. At present, ownership in China is highly concentrated among the legal person, state and domestic individual or institutional investors. Shares quoted in the Chinese stock exchanges are tradable, except those held by the legal person and state.

The remainder of the paper is organized as follows: In section 2, we review some related literature. Section 3 describes the sample data and methodology used in the empirical analysis. Section 4 presents the empirical results and discusses the implications of these results, section 5 concludes the paper.

Literature review

Theoretical and empirical studies, especially in Western countries like the US and the UK have emphasized the need for good corporate governance (Denis and McConnell, 2003; Jensen and Meckling, 1976). Studies in multiple countries provide evidence of the importance of corporate governance by examining the critical relationship between ownership structure and firm performance. In modern corporations, the separation of ownership and control gives rise to the much researched principal-agent problem that may lead to poor performance due to the weakness of corporate governance systems (McConnell and Servaes, 1990; Thomsen and Pedersen, 2000; Shleifer and Vishny, 1997). Distribution of ownership of the firm through shareholdings is a major influences on firm performance.

Literature on corporate governance has identified two types of corporate ownership structures, these being: dispersed ownership and concentrated ownership structures. In firms where the ownership structure is dispersed, shareholders may lack the incentive to monitor the activities of management; they may also find it difficult if not impossible to monitor the activities of the agent (management). Grossman and Hart (1980) report that shareholders in widely dispersed companies lack adequate incentives to closely monitor management. Monitoring the agents in dispersed firms generates costs that might not be commensurate with the derived benefits. With most developing countries such as China ownership and control is concentrated. Studies demonstrate that large shareholders are likely to play an active role in ensuring compliance with corporate governance

standards (Shleifer and Vishny, 1997; Denis and McConnell, 2003; Khanna and Yafeh, 2005). Thus, concentrated ownership structures provide better incentives to monitor the activities of managers. The ability of large shareholders to monitor managers may in turn lead to superior firm performance, from which the shareholders stand to benefit. However, monitoring management is associated with agency costs, which may erode the benefits accruable to minority shareholders (Jensen and Meckling, 1976). Thus small shareholders are unlikely to make the effort involved in such monitoring.

Empirical research, essentially from the mature market economies and emerging markets, provide evidence, though with mixed reports, on the effect of ownership on firm performance (Denis and McConnell, 2003; Shleifer and Vishny, 1986; Xu and Wang, 1999; Choe and Yin, 2000). In one such study Holderness and Sheehan (1988) noted that performance of publicly quoted firms rises with an increase in ownership concentration. In a sample of 114 firms quoted on the New York and American stock exchanges, Holderness and Sheehan (1988) observed Tobin Q and accounting profits to be significantly lower for firms where individuals form the majority of owners than for firms where a corporate body forms the majority owner. In another study, Boardman and Vining (1989) closely analyze and compare private, mixed enterprises and SOEs of the 500 largest non-U.S. industrial firms. In their report, they found mixed enterprises and SOEs to perform worse than similar private enterprises. While Thomsen and Pedersen (2000) found a non-linear relationship between ownership concentration and firm performance, McConnell and Servaes (1990) in their sample of 1000 firms, report Tobin Q to have positive correlation with institutional shareholdings. In contrast, Demestz and Lehn (1985) in a study of 511 large corporations, found no significant correlation between ownership concentration and accounting profit.

Furthermore, Wu et al., (1996) in a study of Chinese publicly quoted companies, found ownership concentration to have an inverse U-shape with firm performance. Firms with large shareholders, especially in developing countries, are believed to be favorably disposed in terms of improvement in value, perhaps due to the ability of concentrated shareholders to monitor the activities of the management. Xu and Wang (1999) found the size of the shareholdings of the largest shareholders to be positively correlated with firm performance. In another vein, Zhang et al., (2002) report ownership concentration through state and legal persons, to have a significant positive correlation with firm performance. Similarly, several other studies carried out in China and Eastern Europe report a linear relationship between ownership distribution and firm performance (Claessens and Djankov, 1999b; Chen and Gong, 2000; Hovey et al., 2003).

Sample Data and Methodology

The sample for this study consists of firms listed on both the Shanghai and Shenzhen stock exchanges for the period 2001 to 2005. The sample selection was based on data availability. We also presume listed firms to operate and prepare their records in accordance with the rules and regulations as prescribed by the regulatory bodies. In addition, our sample is limited to listed firms due to the fact that data on ownership distribution and performance are not publicly available for firms that are not listed in the stock exchange. Also excluded were firms in the financial industry due to the nature of their financial statements. Furthermore, firms not listed on either stock exchange before the accounting year-end for 2000 and those undergoing a reorganization during the sample period were also excluded. The study is based on data reported as at 31 December each year and was made up of 3,512 firm-year observations, and these are shown in Table 1.

Table 1. Number of firms in the sample for the year

Year	No of firms	% from SHSE	% from SZSE
2001	653	0.58	0.42
2002	701	0.61	0.39
2003	689	0.56	0.44
2004	742	0.62	0.38
2005	751	0.67	0.33
Firm-year Observations	3512		

Data concerning ownership structure and firm performance were collected and computed from firms' annual reports as published by the China Securities Regulatory Commission (CSRC), Shanghai Stock Exchange (SHSE), Shenzhen Stock Exchange (SZSE) and other regulatory bodies. In addition, necessary ratios were computed from the reports of individual firms. To supplement and confirm the data from these reports, key officials both at the stock exchanges and individual firms were interviewed.

This study investigates the relation between ownership structure and performance of Chinese listed firms. The study hypothesizes a positive (or negative) correlation between legal person (state), tradable A-shares and the performance of publicly listed companies. To examine this relationship, we used the pool data regression model. Specifically, we estimate the following regression equation:

$$PERF_{ij} = \alpha + \beta_1 OS_{ij} + \beta_2 DER_{ij} + \beta_3 FSIZE_{ij} + \beta_4 INDDUM_{ij} + \beta_5 YRDUM_{ij} + \mu_{ij}$$

Where:

α = the intercept, β = Regression coefficients and μ = the error term

$PERF_{ij}$ = Performance of firm i in year j {Return on equity (ROE), Return on assets (ROA) and Tobin's Q}

OS_{ij} = Ownership structure of firm i in year j {Proportion of shares held by legal person (P_LP), state (P_STATE), domestic (Chinese) individual or institutional investors (P_T_A-shares), employees (P_EMP) and foreign investors (P_FOR)}.

DER_{ij} = Debt-to-equity ratio of firm i , in year j and $FSIZE_{ij}$ = Firm size of firm i , in year j

$INDDUM_{ij}$ = Industry dummies of firm i , in year j and $YRDUM_{ij}$ = Year dummies of firm i ,

Firm performance is measured in three different ways to enable us to establish variation, if any, in the relation between ownership structure and firm performance. As a result of data availability, we focus on ROE, ROA and Tobin Q as measure of firm performance. Return on equity, is measure of the percentage of net income to the book value of common equity. Return on assets, is computed as the percentage of net income to the book value of total assets and Tobin Q is measure as market value of equity capital plus the book value of firm's debt divided by the book value of total assets. This measure of Tobin's Q is employed due to the unavailability of many years of data in China used to estimate the replacement costs of assets. Our estimation of Tobin's Q is consistent with Ehikioya (2008) and the modified version as used by Chung

and Pruitt (1994). According to DaDalt et al. (2003), the established model by Chung and Pruitt is an accurate measure of Tobin's Q compared with other methods.

In the regression analysis, the explanatory variable is the ownership structures, which comprise P_LP, P_STATE, P_T_A-shares, P_EMP and P_FOR. We measure P_LP as the proportion of shares held by the legal person to the total number of shares. P_STATE is measured as the proportion of shares held by the state to the total number of shares. We measure P_T_A-shares as the total number of tradable A-shares to the total number of shares. Both P_EMP and P_FOR are measured as the proportion of shares held by employees and foreign investors respectively, divided by the number of outstanding shares.

Apart from ownership structure, other factors may also influence performance. To control for such factors, we introduce FSIZE, DER, INDDUM and YRDUM. Firm size is measured as the natural logarithm of total assets and controlled for size effect. Debt to equity ratio is measured as the book value of total debt, divided by the book value of total assets. To control for industry effect, we introduce an industry dummy, taking the value of one if the firm i has in industry j and zero otherwise. To control for macroeconomic shocks that may stem from the environment over time, we include year dummy variable that equals one for year j and zero otherwise.

Results and Discussion

Table 2. Descriptive summary statistics of variables

Variable	Mean	Std. dev.	Lower quartile	Upper quartile
ROE	0.137	0.082	0.009	0.456
ROA	0.085	0.058	0.036	0.291
Tobin's Q	1.918	1.384	0.50	24.57
P_LP	31.86	29.5	0.00	0.913
P_STATE,	28.33	26.2	0.00	88.38
P_T_A-shares	29.80	12.01	0.00	69.01
P_EMP	3.31	8.31	0.00	47.07
P_FOR	6.01	12.36	0.00	59.10
DER	1.475	1.252	0.08	19.08
FSIZE	16.21	2.865	8.65	26.63
Industry Dummy	0.615	0.197	-	-
Year Dummy	0.419	0.207	-	-

This section provides a summary of the descriptive statistics of variables. As presented in Table 1, the mean of ROE and ROA (Tobin Q) is 0.137 and 0.082 (1.918) respectively. The mean for the legal person level of ownership in the sample is 31.86 with a standard deviation of 29.5. The mean (standard deviation) percentage of other ownership structures such as state and tradable A-shares is 29.80 (12.01) and 28.33 (26.2) respectively. Both employees and foreign shareholders have the lowest mean of

3.31 and 6.01 in the ownership structure. This indicates that the ownership of Chinese listed firms is concentrated in the hands of legal person, state and domestic individuals or institutions. The employees and foreign investors are shown to have insignificant power to monitor and control the activities of the management. While firm size has an average of 16.21, a standard deviation of 2.865 and ranges from 3.65 to 26.63, debt to equity ratio has an average of 1.475, a standard deviation of 1.252 and ranges from 0.08 to

19.08.

In our regression analysis, to check whether our results are sensitive to alternative specifications, we used three different performance variable measures of ROE, ROA and Tobin's Q. We included the industry and year dummies in our analysis, though their coefficients are however not reported, since they are only included as control variables. We begin by examining the impact of ownership structure on performance. The results for the pooled regressions are reported in Table 3 with significance at 1% and 5% levels. Column 1 of the table reveals the regression results when ownership distribution is regressed with ROE. As shown in Column 4, a similar

set of results is obtained when ROA is used. In Column 7, we excluded some variables so as to observe if there could be possible changes in the direction of the relationship, however, the results remain the same. Generally, with the exception of state ownership that has a significant negative relation with performance, the results show a significant positive association between the proportion of legal person, domestic individual or institutions ownership structure with firm performance. The positive relationship between employees, offshore and performance is however insignificant suggesting no influence.

Table 3. Coefficient estimates of variables pooled

This table presents the coefficients of OLS regression of performance on various corporate governance variables.

Explanatory variables	Dependent variable (Performance)								
	ROE			ROA			Tobin's Q		
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9
		0.05283				0.020132	0.002830		
P_LP	0.008 (2.291)a	(2.30316)	0.091213 (3.420)+	0.003 (2.519)a	0.032 (0.284)	(1.09360)	(3.159)a	0.004 (3.153)a	0.05655 (1.3940)
P_STATE	-0.0130 (-1.48)a	-0.0409 (-0.928)	-0.012 (-2.264)+	-0.0012 (-2.28)a	-0.032 (-0.284)	-0.1440 (-0.170)	-0.00575 (-0.0609)	-0.03210 (-0.012)*	-
P_T_A-shares	0.029 (1.431)	-0.409 (-0.928)a	0.012 (1.264)+	0.0119 (1.0517)	-0.0264 (-1.008)a	0.012 (1.274)+	0.037210 (0.1829)	*	-
P_EMP	0.003 (0.016)	-	-	0.017 (0.018)	-	-	-	-	-
P_FOR	0.008 (0.363)	-	-	0.0119 (0.017)+	-	-	-	-	-
DER	-0.04714 (-2.140)	-0.2006 (-4.015)a	-	-0.0318 (-1.224)	-0.0702 (-2.137)	-	-0.23000 (-3.159)*	0.0315 (0.0190)	-
FSIZE	1.012 (5.140)a	0.968653 (3.27206)	-	2.0016 (6.5110)+	1.5403 (6.140)	-	2.9689 (7.037)a	1.036 (4.076)a	-
INDDUM	YES	YES	YES	YES	YES	YES	NO	NO	NO
YRDUM	YES	YES	YES	YES	YES	YES	NO	NO	NO
Intercept	0.0102 (2.38)	-0.019584 (-0.58483)	0.217 (6.251)	0.002653 (1.188776)	0.131371 (0.76217)	-0.24053 (-1.262)	-0.036 (0.420)	-0.22840 (-0.962)	0.01958 4 (0.583)
Adjusted R - squared	0.301	0.273	0.231	0.292	0.251	0.240	0.271	0.210	0.292
F - statistics	50.196	53.869	53.018	62.769	51.005	56.075	53.069	50.371	49.005

The values in parentheses are t – values and a, +, * denotes 1%, 5% and 10% levels of significance respectively

The negative relation between state and performance may be due to the inefficiency of state management procedures. These may be explained by government's interest in pursuing political objectives such as maximum employment in these firms rather than profit maximization. In addition, the conflict of interest between government with its political agenda and shareholders who are strongly prefer profit maximization may affect the performance of management. The significant positive relationship between legal persons, domestic individual or institutions with performance demonstrate the motivation and ability of a concentrated ownership structure to monitor and influence the activities of the firm's management. Legal persons with substantial

interest therefore improve firm performance through direct control from the board.

In contrast, the coefficients of debt to equity ratio show a significant negative correlation with performance. This might be due to the fact that highly leveraged firms tend to perform poorly (Xu and Wang, 1999). Another explanation may be that because debt in China is mainly supplied by government controlled institutions. The use of debt by SOEs from government controlled institutions may lead to lack of drive on behalf of the SOE's management to push the company to perform well. It also suggests that there may be a substantial influence of interest rate costs of debt in firm performance. Firm size is also found to have a significant positive

relationship with firm performance. This indicates that larger firms perform better than smaller firms, perhaps because of favorable government policies to protect the larger SOEs, or significant economies of scale. Additionally, the improved performance shown may be due to the ability of larger firms to attract support to undertake large, positive net present value investments.

In Table 4, we examine on one hand, the relationship between the proportion of legal person in the investment structure against performance, and on the other, we investigate the correlation between the proportion of state ownership with firm performance. In Column 1, the coefficient of LP is significantly positively related to firm performance, measured as the firm's ROE. This suggests the ability of LP to monitor and influence the activities of management. Column 2 of the same table shows state proportion of

ownership to have a significantly negative relationship with performance, indicating the inefficiency of firms in which the state has a greater control. In addition, when alternative measures of performance shown in Column 3 and 4, are applied, the results are still the same. In Column 5 and 6, we excluded industry and year dummies to see if there would be any change in the direction of the relationship. We found that although there is no noticeable change in LP, the coefficient on state ownership shows a positive relationship with firm performance. However, the result is statistically insignificant and thus may have no real influence on firm performance. The coefficients for firm size, and debt to equity ratio, are almost the same for the entire regression analysis in the table. The results provide further evidence on the positive influence of firm size on firm performance in different industry and year.

Table 4. Coefficient estimates after dropping variable(s) (2005)

Explanatory variables	Dependent variable (Performance)					
	ROE		ROA		Tobin's Q	
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
P_LP	0.008 (8.291)a	-	0.003 (3.519)	-	0.0041 (3.153)a	-
P_STATE	-	-0.090121 (-4.420)*	-	-0.02201 (-2.0360)	-	0.0056 (0.390)
P_T_A-shares	0.0029 (2.031)	0.00162 (3.044)+	0.01019 (1.09517)	0.0050 (0.61070)	0.003710 (0.4229)*	0.00615 (0.0190)
P_EMP	-0.00130 (-0.048)a	0.0020 (1.015)	-0.0014 (-1.1004)	0.0001 (0.0110)	0.0036 (1.01706)a	0.0055 (1.009)
P_FOR	0.0018 (1.3063)	0.0663 (0.2610)	0.0119 (0.0017)	0.0002 (0.14110)	0.0111157 (0.246231)*	0.0003 (1.0159)*
DER	-0.008 (-3.140)	-0.003 (-2.489)	-0.0138 (-2.224)	-0.004 (-3.103)a	-	-
FSIZE	0.0012 (3.0157)	0.00132 (7.9360)	0.0016 (10.504)+	0.0005 (6.0390)	-	-
INDDUM	YES	YES	YES	YES	NO	NO
YRDUM	YES	YES	YES	YES	NO	NO
Intercept	2.00502 (8.02008)	0.0177 (3.06450)	0.00263 (1.18076)	0.00053 (1.90262)	0.00316 (1.41200)	0.019584 (1.52856)
Adjusted R - squared	0.295	0.271	0.291	0.235	0.245	0.274
F - statistics	51.990	49.001	51.642	41.005	43.921	42.706

Superscripts a, +, and * denotes significant at 1%, 5% and 10% levels respectively. The values in parentheses are t – values

In China, most listed firms are characterized as having a mixed ownership structure with the legal persons, state and domestic individuals or institutional investors as major shareholders with dominant interests. In this study, we examined too the influence of LP or State dominance on performance. In other words, we investigate the effect of the dominant ownership structure on firms' performance where LP or state has the dominant holding. To examine this effect, we selected 48 firms where the LP is dominates and another 48 firms where the state is dominates. Both selections had 144 firm-years

observations. Empirical results are presented in Table 5 and 6. As reported in Table 5, firms dominated by LP indicate ownership concentration to be significant at the 1% and 5% levels. Thus, there is a strong positive relationship between ROE and LP. Also, we found ROA to have a significant positive correlation with the proportion of shares held by LP, in LP dominated firms. Although Tobin's Q still showed a positive relationship with LP, the level of relation is however, low compare with the results from ROE and ROA.

Table 5. Results on the influence of LP dominated firms

Explanatory variables	Dependent variable (Performance)		
	ROE	ROA	Tobin's Q
(No of firms = 48)			
P_LP	0.008 (12.001)a	0.003 (8.00169)	0.004 (3.80153)a
P_T_A-shares	0.0020 (6.03611)	0.00011 (3.0555)	0.000210 (1.8357)a
P_EMP	0.0130 (1.48)+	0.0012 (1.028)+	0.036 (1.076)
P_FOR	0.108 (0.9363)	0.01019 (1.017)+	0.0005157 (0.7812)*
DER	-0.0041 (-3.140)+	-0.038 (-7.0824)	-
FSIZE	2.0001 (9.17504)a	0.0001 (7.504)a	-
INDDUM	YES	YES	NO
YRDUM	YES	YES	NO
Intercept	2.0161 (12.0796)	1.94441 (9.11036)	0.0364 (5.9104)
Adjusted R - squared	0.376	0.353	0.332
F - statistics	21.011	19.106	13.821

Superscripts a, +, and * denotes significant at 1%, 5% and 10% levels respectively. The values in parentheses are t – values

Table 6. Results on the influence of STATE dominated firms

Explanatory variables	Dependent variable (Performance)		
	ROE	ROA	Tobin's Q
(No of firms = 48)			
P_STATE	-0.08541 (-9.420)a	-0.00132 (-5.18090)	0.05177 (0.43190)+
P_T_A-shares	0.012 (3.264)+	0.04260 8.2110	0.0315 (2.90190)
P_EMP	0.0026 (2.00015)a	0.003 (1.3564)	0.00575 (0.0609)
P_FOR	0.00653 (0.924606)	0.002 (0.78140)	0.283000 (3.159)+
DER	-0.283000 (-3.1599)*	-1.0146219 (-6.094217)a	-
FSIZE	0.0089 (12.037)a	0.015157 (5.2931)*	-
INDDUM	YES	YES	NO
YRDUM	YES	YES	NO
Intercept	0.012417 (16.0251)	-0.24053 (9.0162)	0.019584 (10.583)
Adjusted R - squared	0.327	0.341	0.269
F - statistics	18.141	16.806	12.479

Superscripts a, +, and * denotes significant at 1%, 5% and 10% levels respectively. The values in parentheses are t – values

On the other hand, for state dominated firms, ROE and ROA strengthen the negative association with an increasing proportion of shares held by the state. The result is however, differs from the relationship between Tobin's Q and state ownership, as this relationship is insignificantly positively correlated. In all, the empirical results for A-shares, employees, offshore, debt-to-equity ratio, and firm size are similar to those reported in Table 3 and 4. Generally, positive ownership concentration is felt more in firms dominated by LP than in firms dominated by the state. This again shows the policy direction of the government to pursue social interest in contrast to LP that is strongly seeking profit maximization. In keeping with this difference in management priorities, operating inefficiency is also greater in government controlled firms.

Conclusions

The persistent advocacy for corporate governance across the globe has valuable insights for the study of ownership structure effects on the performance of firms in emerging markets. Since the late 1970s, when

China formally opened up to outside markets, the country has been through many reforms, which have included the re-structure of most SOEs. The unique institutional framework of China has through this restructure, generated consistent double digit GDP growth in recent years. The study used sample data of firms listed on the SHSH and SZSE for the period 2001 to 2005, covering this period of rapid expansion, to investigate the impact of ownership structure on the performance of Chinese listed firms. Overall, empirical evidence in this study demonstrates that ownership structure certainly does matter in China, and perhaps, in other emerging markets.

The results of our investigation suggest the need for ownership concentration, but, not in the hands of the state, as inefficiencies related to the state ownership severely reduce firm performance. To ensure efficiency and improvement in performance, there is a need for government to reduce its equity shareholdings in listed firms. In addition, it is also recommended the state to should establish an effective monitoring, control and incentive system to ensure that the managers act in the best interest of the investors. Specifically, the proportion of legal person

and domestic individual or institutional shareholdings are found to be positively and significantly associated with improved firm performance. Thus, ownership concentration should largely be in the hands of institutions and individual investors with incentives to monitor and influence the activities of the management. Although the results show employees and foreign shareholdings too have positive effect on performance, the influence found is insignificant. The stronger positive effect of ownership concentration in LP dominated firms over state dominated firms, again raises the question as to the efficiency of adopting dispersed ownership in emerging markets, such as China. Furthermore, it shows the need for the state to reduce its controlling interest in order to ensure a higher level of firm performance.

In addition to ownership structure, other factors such as size, and debt to equity ratio, are found to be significant in determining firm performance. While firm size is found to have a significantly positive relationship with performance, debt to equity ratio is found to have a significantly negative correlation with firm performance. This suggests that debt to equity ratio is an impediment to increasing the value of the firm. Although this study may not be completely free from research bias, we have systematically demonstrated the impact of ownership structure on performance of Chinese listed firms. Thus, we suggest further studies to take account of SOEs yet to be listed in the stock market. The inclusion of other performance and control variables would also merit further consideration.

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