GOVERNANCE AND PERFORMANCE IN COMPLIANCE VERSUS NON-COMPLIANCE CHINESE LISTED COMPANIES

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Abstract

Cases of corporate scandals and the misconduct of publicly listed companies (PLCs) are growing amid rapid economic development in China. Systematic research on governance factors affecting these corporate misconducts and their consequences is however scant. This study compares the key governance characteristics of Chinese PLCs that were found to have contravened regulatory compliance requirements (i.e., "non-compliance" PLCs) to those that were not (i.e., "compliance" PLCs). Based on a comparison between 53 pairs of compliance- and non-compliance-PLCs over the period from 2001 to 2006, our results show that there are significant differences between the two. We found that ownership concentration is higher in compliance firms that also compensate their directors and executives at higher levels. Furthermore, the results suggest that sound governance practices benefit firms socially and financially, and an effective internal monitoring mechanism can further differentiate good companies from bad companies such that the good companies perform better.

Keywords: corporate governance, regulatory compliance, ownership structure, compensation, China

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Introduction

Many of the world's corporate failures and misconduct in recent times have been associated with corporate misbehavior, highlighting the need for having good corporate governance frameworks and practices. Though countries are in a race to develop sound corporate governance systems, the regulatory enforcement of governance compliance in many developing nations remains ineffective (Berglöf and Claessens, 2006). China is no exception. With sustained rapid economic growth in China, reports of corporate scandals and misconduct, particularly at the top levels, have also become widespread in recent years. Some of these scandals involved top leaders of the country's largest business enterprises, including its major state-owned banks (Tam, 2008). Systematic research on the factors driving this corporate misconduct and its consequences, however, is scant.

Is corporate misconduct common in China? What are the governance factors that affect corporations' misconduct and how does misconduct affect shareholder value? To address these questions, our study investigates the key corporate characteristics and performance outcomes of China's publicly listed companies (PLCs) that were found to have contravened regulatory compliance versus companies that were not. It examines whether PLCs with misconduct exhibit any significant differences in governance practices and performance as compared to their complying counterparts.

Collecting the cases of non-compliance that were identified and penalized by the Chinese stock market watchdog, the China Securities Regulatory Commission (CSRC), over the period from 2002 to 2006, we found 53 companies engaged in misconduct. After using a random sampling technique to find 53 matched pairs of compliance firms, and after collecting the firms' prior compliance or non-compliance data from 2001, the final sample consisted of 106 companies with a total of 636 firm-year observations. The findings from this study show that ownership concentration is higher in compliance firms, indicating that large shareholders have greater incentives and efficiency in monitoring firms' behavior (Shleifer and Vishny, 1997). The results also show that executives and directors receive higher compensation than their peers in non-compliance firms do, suggesting that attractive compensation packages could deter corporate shirking behaviors. Apart from better governance practices, compliance firms outperform their non-compliance counterparts, which suggests that compliance is not simply a "tick-the-box" exercise; it brings social and financial benefits to firms.

The remainder of this study is organized as follows. We discuss the background of China's corporate sector and legal environment in Section 2. Section 3 reviews the literature and formulates our theoretical hypotheses. Section 4 describes the research design, sample selection and variable measurements. Results and discussions are provided in Section 5, and Section 6 concludes the paper.

China's corporate sector and legal framework

Two Chinese stock exchanges, the Shanghai Stock Exchange (SHSE) and the Shenzhen Stock Exchange (SZSE), were established in 1990 and 1991, respectively, in conjunction with the country's economic reforms. As a part of "corporatization", many state-owned enterprises (SOEs) were selected and filed for initial public offering on the basis of provincial and local government quotas rather than on their financial soundness. However, a large number of these companies did not perform well after going public, and they did not engage in proper governance practices. For instance, a study by Schipani and Liu (2002) showed that some companies did not even convene regular meetings of the board of directors. Moreover, the major corporate scandals such as those involving Yin Guang Xia Co Ltd, Zhengzhou Baiwen Co Ltd, and Lantian Co Ltd, which were uncovered in 2000, have further raised the growing concerns over the efficiency of the governance mechanisms of Chinese companies. In response, the CSRC has released two major corporate governance regulations to strengthen the corporate sector and improve investor confidence. The two key governance regulations are (1) *"The Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies"* (CSRC, 2001, released on 16 August 2001) and (2) *"The Code of Corporate Governance for Listed Companies in China"* (CSRC, 2002, released on 7 January 2002), which put greater emphasis on internal control mechanisms and on independent nonexecutive directors.

In the Chinese context, a concentrated ownership structure is the key characteristic of PLCs, with the state often being the largest shareholder, holding more than 45 percent of the total shares on average in a listed company (Dong and Gao, 2002). Studies of the ownership structures of Chinese companies have found mixed results. Some research shows that concentrated ownership is detrimental to firm performance (Hu et al., 2010; Xu and Wang, 1997), which can be attributed to the different objectives and goals among the controlling shareholders and other shareholders (Laffont and Tirole, 1991; Turnbull, 2005), managers' opportunistic behavior (Ma, 2000; Wei, 2000), and ineffective external control mechanisms (Lee and Hahn, 2001; Qian, 1995). Others compare state ownership with legal person ownership and private ownership, suggesting that different types of ownerships may exert different impacts on firm performance (Chen et al., 2009; Wang, 2005).

Given the country's weak legal system and inactive external control mechanisms, the effectiveness of internal governance mechanisms becomes more vital in Chinese firms (Hu et al., 2010). Subsequently, we develop a model that focuses on how ownership structure under strong state intervention may influence governance compliance and thereby affect firm performance for Chinese PLCs. Figure 1 depicts the model of the relationships among the variables examined in this paper.

The model builds upon the regulatory framework and the current developments of the corporate sector and corporate governance in China. Ownership structure is a product of state interventions and market development in the Chinese corporate sector. This paper shows that differences in ownership structures can affect the behavior of agents through variations in compensation schemes and the fulfillment of corporate goals and social objectives, thereby resulting in different levels of corporate governance compliance behaviors and firm performance. The following section explores the literature framework that supports the formation of this model.

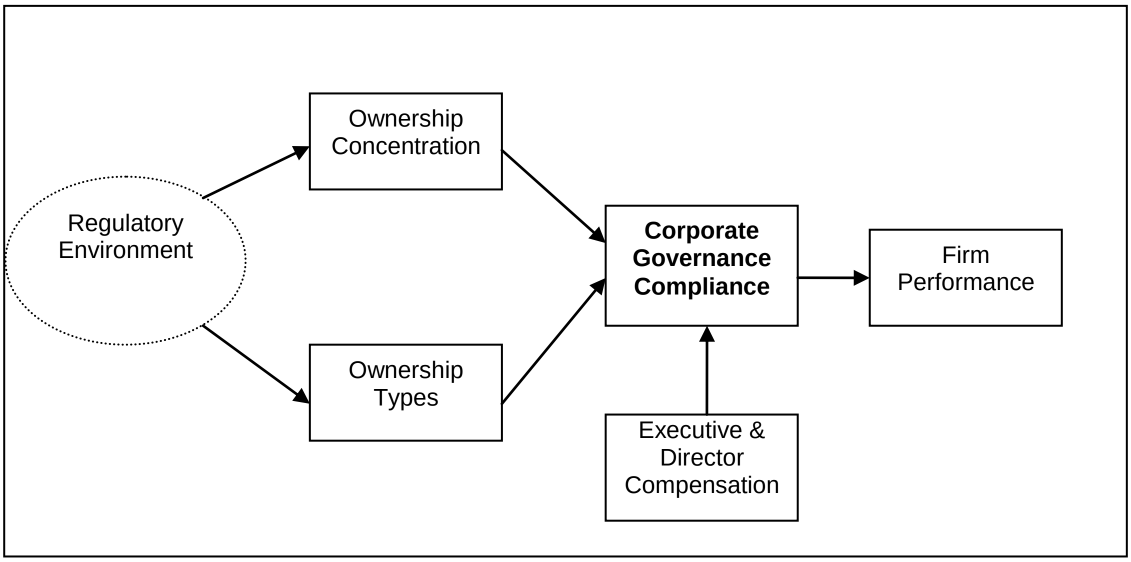

Figure 1. This framework depicts the relationships among ownership structure, corporate governance compliance, board and executive compensation and firm performance

Literature review and hypotheses development

Ownership concentration and corporate governance compliance

Ownership structure is clearly one of the most important governance mechanisms (Connelly et al., 2010; La Porta et al., 1999). With the separation of ownership and control in Anglo-American companies, agency theory suggests that a low level of monitoring could result in a higher level of agency costs (Jensen and Meckling, 1976). Thus, without a strong monitor, managers have ample room to engage in shirking behaviors that potentially hurt shareholders' welfare. By contrast, the presence of large shareholders can overcome the 'free rider' problem of dispersed ownership and therefore diminish the agency problem. With a higher ownership concentration, there is more incentive for the largest shareholder to perform the monitoring (Shleifer and Vishny, 1997). The ownership structure can therefore be an important determinant of the level of monitoring and the quality of corporate governance compliance within a firm. For example, Anderson and Reebs (2003) show that a high level of ownership concentration results in the more effective monitoring of firm managers by the largest shareholder, which in return is better aligned with the interests of the other shareholders. Therefore, we argue that a higher ownership concentration can reduce the incidences of corporate misconduct. Hypothesis 1 is formulated as follows:

> *Hypothesis 1: Compliance firms have higher ownership concentrations than non-compliance firms.*

Ownership types and corporate governance compliance

Apart from ownership concentration, the type of large shareholder who holds the most control of a PLC also affects the quality of corporate governance compliance. In China, neither family ownership nor institutional investors have a significant presence yet; rather, it is the State that plays a predominant role. In a Chinese listed company, shares are either owned directly by the State at various levels, by Legal Persons (i.e., SOEs) that are majority owned by the State, or by private enterprises and individual shareholders. However, empirical findings on the performance implications of these different types of ownerships are mixed. By means of a study of over 500 companies listed on the Chinese stock exchanges during the period of 1993 to 1995, Xu and Wang (1997) find that corporate performance is negatively related to the proportion of a company's shares that are owned by the state, but holdings by legal persons are positively related to firm performance. This can be explained by the conflicts of interest between the government and the shareholders, which is a source of inefficiency (Laffont and Tirole, 1991). Also, when legal persons' equity holdings in the firm are high and their objectives are to maximize the firm's value, the goal is the same as that of outsider shareholders (Morck et al., 1988). Empirically, this viewpoint is also supported by Qi *et al.* (2000), Hovey, Li and Naughton (2003) and Chiou and Lin (2005), who showed that there was a positive correlation between legal person shares and firm performance.

In contrast, some researchers argue that state ownership may not be less efficient than private ownership (Kay and Thompson, 1986; Kole and Mulherin, 1997). Chen (1998) finds that firm performance is positively related to state ownership rather than to legal person ownership. Likewise, Che and Qian (1998) argue that local government state ownership can signal a commitment mechanism to the market and offers necessary support to enterprises. A study by Tian (2001), which finds a U-shaped pattern between state ownership and firm performance, stresses that the government offers both 'grabbing' and 'helping' hands. Sun *et al*. (2002) also suggest that partial state ownership has a positive impact on firm performance. In fact, a U-shaped pattern between government ownership and firm performance indicates that a certain level of state ownership is to be encouraged, but not in excess. Perotti (2004) concludes that in transitional economies where proper control mechanisms are not well established, a residual degree of state ownership might be necessary. A hypothesis on the possible link between different types of shareholders and corporate governance compliance in China is therefore formulated as follows:

Hypothesis 2: Corporate governance compliance varies according to ownership type.

Compensation and corporate governance compliance

Executive compensation serves as an important mechanism in aligning the interests of directors and managers with those of their shareholders. A competitive compensation package can also lead to good management and better firm performance (Buchholtz et al., 1998; Stanwick and Stanwick, 2001). With China's booming economy, large Chinese firms and foreign-invested companies in the country are starting to offer attractive compensation packages to attract and retain good talent. We argue that directors and executives in firms with competitive compensation packages will be more inclined to engage in better governance compliance than their counterparts for three reasons. First, it is well accepted that a manager's compensation is related to the value and scarcity of the skill set that the manager brings to the firm. Therefore, capable and competent managers are more likely to negotiate a better compensation package for themselves and are more inclined to comply with best practices, standards, and governance regulations. Second, the market for managers in China is becoming increasingly competitive and might be sufficient to differentiate good from bad talent as well as good from bad firms. Third, poor compensation structure may also increase managers' shirking behaviors, leading to greater possibilities of misconduct. Therefore, the compensation of managers and directors is higher in compliance firms than their non-compliance counterparts. Hypothesis 3 is developed as follows:

Hypothesis 3: Director and executive compensation is higher in compliance firms than it is in non-compliance firms.

Corporate governance compliance and firm performance

From the 1997 Asian Financial Crisis to the recent 2008 Global Financial Crisis, poor corporate governance has been one of the key reasons for many corporate collapses (Claessens et al., 1999; Kirkpatrick, 2009). On the one hand, many studies report that good corporate governance could provide improvement when a company is underperforming due to poor management (Lipton and Lorsch, 1992), lead to a better-performing board (IBR, 2000), or result in less incidences of corporate misconduct (Chen et al., 2006). On the other hand, Dalton et al. (1998) show that the relationships between corporate governance and firm performance can be inconclusive. This is partly due to the complexity in defining corporate governance, which results in a difficulty in identifying variables to measure it precisely. This study attempts to avoid the ambiguity of what constitutes corporate governance by examining the relationship between the compliance of the regulatory framework and firm performance. Firms that are found to be non-compliance are determined by the existing legal framework and governance requirements. We adopt a holistic view that corporate governance is the complete strategic and operational system put in place as a monitoring mechanism to safeguard the interests of shareholders. Therefore, we propose that firms that are non-compliant in terms of corporate governance requirements show worse performance. Hypothesis 4 is formulated as follows:

Hypothesis 4: Compliance firms perform better than non-compliance firms.

Methodology

Sampling and data collection

The data are composed of all non-compliance Chinese listed companies that were identified and penalized by the CSRC between 2002 and 2006. After exclusion of the missing data, a final sample of 53 PLCs was found to be non-compliance. A control group is constructed by selecting PLCs paired with each non-compliance company based on their relevant sector (according to the CSRC's sector code) and firm size. As a result, a group of 53 compliance PLCs are collected. Because the non-compliance cases occurred between 2002 and 2006, prior data on ownership structure, board structure and the firm performance of these firms were collected to cater for a potential lag effect. Therefore, three years of data are collected from the firms' annual reports from 2001 to 2003. In total, 106 PLCs consisting of non-compliance and compliance companies and 636 firm-year observations are used for this study.

Variables

A *non-compliance* dummy variable is used to differentiate between non-compliance (coded one) and compliance (coded zero) firms, which is consistent with the prior research (e.g., Chen et al., 2006). Details of different categories of non-compliance and their respective monetary fines are also collected for testing. The variables of ownership structure are composed of ownership concentration and ownership type. *Ownership concentration* is measured by the percentage of the shares owned by the largest shareholder in a firm and often has great influence over firms' corporate behaviors (Chen et al., 2006). *Ownership type* is defined by the type of shares owned by the largest shareholder. According to the CSRC classification, there are three major groups of ownership types: state-owned shares, legal person shares, and state legal person shares. Collected from firms' annual reports, the *compensation* variable is measured by (1) the total compensation of the board members, (2) the average compensation of a director, and (3) the average compensation of an executive. Lastly, *firm performance* variables are measured by return on assets (ROA) and earnings per share (EPS), which are frequently used as a primary measure of a firm's profitability and share performance (May et al., 1975; Stickney and Weil, 1994).

Results and discussion

Table 1 shows the descriptive statistics for the variables. The average amount of fines imposed on each non-compliance firm is approximately RMB 626,245. This amount has increased significantly over the years. The amount of fines imposed on an average individual offender across all non-compliance firms is approximately RMB 62,688, which may be considered to be relatively low in comparison to the penalty that is imposed in the Western world. Ownership concentration is estimated at 40% of all outstanding shares in an average firm in the sample, while the aggregate amount of the top ten shareholders is about 60%. Average board size in the sample firms is 9.58, while board independence is close to the standard one-third ratio of independent directors on an average board, which is also the minimum requirement on board independence set by the CSRC (CSRC, 2001). Firm performance is low on average, with ROA of -0.06 and EPS of -0.06. The total compensation amount received by board members is approximately RMB 98,394, with the average compensation level of an executive (i.e., RMB 35,557) being higher than that of a director (i.e., RMB 29,241).

Table 1. Descriptive statistics of variables

Variables	Mean	Median	Std. Deviation	Min.	25th Percentile	75th Percentile	Max.	*n*
Compliance[1]	.50	.50	.50	0.00	-	-	1.00	106
No of Offenders[2]	3.98	0.00	5.60	0.00	0.00	9.00	24.00	53
Fine Type[3]	3.04	3.00	1.19	1.00	2.00	4.00	5.00	53
Total Fine (RMB)	626244.67	560000.00	541732.21	0.00	100000.00	905000.00	1910967.00	53
Fine Per Person[4]	62688.28	63333.33	54243.89	0.00	1071.43	97777.78	191667.00	53
Executive Fine[5]	112830.19	30000.00	181207.25	0.00	0.00	175000.00	880000.00	53
Insider Fine[6]	297924.53	190000.00	336431.26	0.00	0.00	465000.00	1270000.00	53
Insider Fine/Total Fine	.36	.38	.30	0.00	0.00	.56	1.00	53
Largest Shareholder Type[7]	1.93	2.00	.83	1.00	-	-	3.00	106
Second Largest Shareholder Type[8]	2.16	2.00	1.24	1.00	-	-	5.00	106
Largest Shareholding[9]	40.13	38.00	15.46	12.06	27.60	52.34	75.82	106
Second Largest Shareholding[10]	10.41	8.91	8.45	0.01	2.75	17.30	29.58	106
Top 10 Shareholding[11]	60.08	60.94	11.39	25.49	52.94	68.47	89.20	106
EPS	-.05	.01	.57	-1.82	-.29	.17	2.36	102
ROA	-.06	-.01	.15	-.55	-.10	.03	.15	104
Board Size	9.58	9.00	1.88	5.00	8.33	10.33	16	106
Independent Directors per Board (%)	0.29	0.30	0.07	0.00	0.26	0.32	0.60	106
Total Board Compensation	98394.46	70931.04	83413.73	8081.00	44986.33	123090.65	408411.00	104
Average Director Compensation	29241.76	25242.42	23047.56	0.00	12000.00	38615.38	116522.00	103
Average Executive Compensation	35557.24	27923.08	29000.10	4968.00	17939.46	41538.46	139829.00	103

[1] Dummy variable; 1 indicates non-compliance, otherwise 0. [2] Number of offenders involved in each non-compliance case. [3] Dummy variable; refer to Table 3 for types of non-compliance. [4] The amount of fine imposed on each offender in a non-compliance case. [5] The total amount of fine imposed on executive members in a non-compliance case. [6] The total amount of fine imposed on firm insiders in a non-compliance case. [7] Dummy variable; 1 indicates state, 2 indicates state-legal-person, otherwise 0. [8] Dummy variable; 1 indicates state, 2 indicates state-legal-person, otherwise 0. [9] Shares owned by the largest shareholder. [10] Shares owned by the second largest shareholder. [11] Shares owned by the top 10 largest shareholders. These variables are used in the subsequent tables.

Table 2 shows that the number of cases of non-compliance has been indeed on the rise over the years. The number peaked in 2004 and gradually decreased in 2005 and 2006. This decrease might be due to the increasing efforts and emphasis on developing and enforcing corporate governance standards and good corporate reputations to attract investments in the private market by the government.

Table 2. Frequency table of non-compliance offences between the years 2002-2006

Year of Offence	Frequency	Percent	Cumulative Percent	*N*
2002	9	17.0	17.0	
2003	3	5.6	22.6	
2004	22	41.6	64.2	53
2005	12	22.6	86.8	
2006	7	13.2	100.0	
Total	53	100.00		

Table 3. Frequency and ANOVA table of types of non-compliance offence

Types of Non-Compliance	Frequency	Percent	Cumulative Percent	Total Amount of Fine (RMB)	*Total Number of Offenders*	*Total Amount of Fine per Offender*
Fail to publish annual report on time	6	11.3	11.3	83,333	0.00	0.00
Fail to disclose significant information	15	28.3	39.6	397,478	5.53	49,030
Fabricate significant information	6	11.3	50.9	436,715	9.50	57,772
Fabricate and fail to disclose significant information	23	43.4	94.3	502,326	11.74	88,703
Fail to publish annual report on time and disclose significant information	3	5.7	100.0	378,990	4.00	66,746
Total	53	100.0		626,245	7.96	62,688
N		53		53	53	53
F-value		n/a		8.330	4.561	13.593
P		n/a		0.000	0.003	0.000

In Table 3, most cases of non-compliance are associated with failures to disclose significant information and/or fabrication of financial information in annual reports. Offences associated with the fabrication of significant information not surprisingly attract higher fines. For instance, members of the Chinese Institute of Certified Public Accountants found that listed companies overstated profits or assets by RMB 220 billion based on their audit of the 2001 annual reports. Therefore, the quality of accounting information and financial statements in Chinese companies is problematic. This implies that China still has a long way to go to achieve quality financial reporting to promote integrity and a healthy disclosure culture. To enhance the corporate reputation and increase investor confidence, this is an essential area where appropriate frameworks and practices should be put in place. It would therefore be desirable for Chinese companies to adopt the transparency and disclosure guidelines contained in the OECD Guidelines on Corporate Governance of State-owned Enterprises so that efficient internal and external audit procedures and functions can be established to provide timely material information according to high-quality internationally recognized standards (OECD, 2005).

Table 4 shows that Legal Person firms have the lowest ownership concentration overall, with an average value of 32%. This supports the notion that the investor class of Legal Persons, like many institutional investors, is less likely than other types of investors to retain control of their firms due to the nature of their investments (Xu and Wang, 1997). Furthermore, the high level of ownership concentration among firms with the state as the dominant shareholder implies that strong government influence may be in place to mitigate the absence of many market structures and instruments needed for the effective functioning of modern corporate governance practices. In Table 5, the ownership concentration by all types of the largest shareholders, namely Legal Person, State, and State Legal Person, is higher in compliances firms. This supports the argument that large shareholders have greater incentives to monitor their firms through concentrated ownership structure (Shleifer and Vishny, 1997). Therefore, the finding supports Hypothesis 1 that compliance firms have a higher ownership concentration than non-compliance firms.

In Table 6, we also find significant differences that distinctively differentiate compliance and non-compliance firms in terms of their ownership structures, which supports Hypothesis 2. First, in nearly half of the non-compliance companies, the Legal Person is the largest shareholder. This shows that the ambiguity inherent in the status of legal person shareholders contributes further to the complexity of the multilevel agency problem. The absence in China of a clearly defined ownership policy that sets out the overall objectives of state ownership has not helped the legal person shareholder in exercising its ownership rights over the companies it invests in. Furthermore, with the rapid corporate restructuring of SOEs in China, more stringent monitoring might have indeed been facilitated by a higher degree of state interest, thereby resulting in better corporate governance behaviors. This result is consistent with the findings by many researchers that, in transitional economies, a residual degree of state ownership might be necessary if proper control mechanisms are not well established (Perotti, 2004).

Table 4. ANOVA results for the level of shareholding according to largest shareholder types

	Shareholder Types	Mean	F	*p*	*n*
Largest shareholding	Legal Person	32.03			
	State	46.39	10.752	0.000	106
	State Legal Person	43.68			
Second largest shareholding	Legal Person	12.60			
	State	7.93	2.868	0.061	106
	State Legal Person	10.25			
Top 10 Shareholding	Legal Person	55.92			
	State	61.80	4.762	0.011	106
	State Legal Person	63.40			

Table 5. ANOVA results for the level of ownership concentration to largest shareholder types between compliance and non-compliance companies

Largest Shareholder Types	Companies	Largest Shareholding	Top 10 Largest Shareholding
Legal Person	Compliance	36.16	54.82
	Non-Compliance	29.81	56.51
State	Compliance	47.54	63.24
	Non-Compliance	44.38	59.28
State Legal Person	Compliance	45.34	66.77
	Non-Compliance	41.68	59.34
F-value		4.837	4.031
P		0.001	0.002
N		106	104

Table 6. Cross-tabulation for largest shareholder type between compliance and non-compliance companies

	Shareholder Types			**Total**	χ^2	*N*
	Legal Person	State	State Legal Person			
Compliance	26.4	39.6	34.0	100.0	6.327	0.042
Non-Compliance	49.1	22.6	28.3	100.0		

Table 7 shows a model where the shareholding of the largest shareholder (ownership concentration) is regressed against the total amount of fines, the number of offenders in each non-compliance case and the amount of fines per person. The results suggest that higher ownership concentration has a negative impact on the amount of fines imposed on non-compliance firms and the number of offenders involved in a non-compliance case. Differences are also detected in the amount of fines between types of offences, with the misrepresentation of information attracting the higher fine, as shown in Table 3. Ownership structure has clearly affected the types of non-compliance behaviors that result for various levels of fines. This implies that the level of monitoring could play a role in non-compliance behaviors, although this paper has yet to find conclusive results due to the limited number of observations of non-compliance cases in the dataset.

The results in Table 8 show that higher compensation is found in compliance firms, and that these firms also perform better than non-compliance firms. For instance, a manager in a compliance firm has an annual compensation of RMB 46,700 as compared to RMB 32,047 for their counterparts in non-compliance firms. This difference in compensation is statistically significant, supporting Hypothesis 3. This also supports the notion that a strong relationship is present between compensation and corporate governance compliance. In addition, good governance practices are associated with better firm performance, as shown in Table 8, which indicates that both ROA and EPS are substantially higher in compliance firms than they are in non-compliance firms. Therefore, Hypothesis 4 is supported, which also rejects the view held by many that corporate governance is merely a compliance exercise. Indeed, it is important to ensure that good compensation schemes foster the long-term interest of the company and create incentives for attracting and keeping qualified professionals (OECD, 2005). Furthermore, the results obtained from Table 8 also suggest that the market for executives and directors in China may be efficient enough to differentiate the quality of managerial talent.

Table 7. Regression models on ownership concentration and the level of monetary fine

	Total Amount of Fine	Number of Offenders Involved in the Non-Compliance	Total Fine Per Offenders
Constant	-	-	-
	(5.019)	(5.138)	(5.474)
Largest Shareholding	-0.271**	-0.249***	-0.324**
	(-2.013)	(-2.620)	(-2.444)
Adjusted R[1]	0.055	0.053	0.081
F Value	4.051	6.866	5.971

[1] upper value shows standardized coefficient, lower value shows t-value, *, **, *** significant at 10%, 5%, 1% levels.

Table 8. This table shows the ANOVA results for various performance and compensation proxies between compliance and non-compliance firms

Companies	ROA	EPS	Total Board Compensation	Average Director Compensation	Average Executive Compensation
Compliance	-0.013	0.120	130,170	39,722	46,700
Non-Compliance	-0.158	-0.519	83,871	26,957	32,047
F-value	9,174	13.356	5.521	3.988	4.419
P	0.003	0.000	0.021	0.048	0.038
N	106	104	106	106	106

Conclusion

China has been rapidly developing its economy and legal systems to support the development of its corporate sector. To promote good business practices and protect shareholder interests, corporate governance has become an important tool for the development of modern corporations in China. Our study has shown a rising number of cases of corporate governance non-compliance while the government is promoting the development of effective corporate governance frameworks and practices in the country. The results suggest that ownership is still concentrated across all ownership types in China. Based on the corporate governance non-compliance cases between 2002 to 2006, this paper finds that the most pressing non-compliance behavior is related to issues of information disclosure and reporting among Chinese listed firms. In fact, half of the non-compliance firms are controlled and owned largely by legal person shareholders, which indicates a higher risk of agency costs in such organizations. This study also affirms that good corporate governance practices enable firms to not only closely align the interests of managers with those of shareholders but also to help firms achieve better performance. Therefore, corporate governance compliance is more than just a “tick-the-box” exercise; it brings social and financial benefits to firms as well.

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