

# Ownership Structure and Corporate Governance among Chinese Securities Firms

**Rongjie Chen**

Tsinghua University, Beijing, China

**Claudia Zhen Qi**

University of Southern California

**Thomas W. Lin**

University of Southern California

*This study examines the impact of corporate ownership structure on the board of directors of securities firms in China. Using a sample of 369 Chinese securities firms from 2003 to 2005, we find that securities firms that are owned by local governments and state-owned enterprises experience more managerial expropriation due to insider control, whereas such firms that are privately owned are more likely to suffer from block holder expropriation. We also find that privately held firms are more likely to hold board meetings frequently and form specialized committees than local government and state-owned enterprises, providing shareholders with more protection against managerial expropriation.*

## Introduction

This paper investigates whether the characteristics of ownership structure of securities firms in China affect their corporate governance through agency costs. We study whether two types of agency costs, managerial expropriation and block holder expropriation are a function of the ownership structure of Chinese securities firms. We divide Chinese securities firms into four groups based on their ownership structure, which we have denominated as an Origin group, a Separation group, a Control group, and a Private group. Firms in the Origin group and Separation group are state-owned, while those in the Control group and Private group are privately owned by a block holder. We hypothesize that managerial expropriation is more prevalent in the Origin and Separation groups and block holder expropriation is more prevalent in the Control and Private groups.

Our analyses focus on firms listed on the Shanghai Stock Exchange (SHSE) from 2003 to 2005. The results are consistent with our hypotheses. Firms in the Control group and the Private group experience more block holder expropriation due to domination of controlling shareholders, than do firms in the Origin group and the Separation. Firms in the Origin group and the Separation group experience more managerial expropriation due to insider control. Additionally, firms in the Control group and Private group are more likely to hold the “Three Meetings” (shareholders’ meetings, directors’ meetings, and supervisors’ meetings) frequently and form specialized committees than firms in the Origin group and Separation group, providing shareholders with more protection against managerial expropriation. Firms in the Separation group are more likely to have specialized committees than are firms in the Origin group.

The paper makes several contributions to the corporate governance literature. Previous studies have focused on the consequences of corporate governance and investigated how ownership structure affected firms' performance (Agrawal and Knoeber, 1996; Mak and Li, 2001; Balatbat et al., 2004; Yeh and Woidtke, 2005; Hui and Zhao, 2008; Ragothaman and Gollakota, 2009; Chalhoub, 2009), executive turnover (Dahya et al., 1998), and the informativeness of earnings (Yeo et al., 2002). While these studies have provided insights into the importance of ownership structure, they have not considered possible mediators, such as governance mechanisms or agency costs. This paper explores possible relationships between ownership structure and corporate governance, providing evidence that ownership structures may affect firms' performance by inflicting agency costs.

Also, this study was performed in a unique experimental setting. China's securities firms have unique variations in their ownership structures which are not found in more developed market-driven economies. Performing an archival-based analysis in such a stark setting is analogous to conducting laboratory experiments and analytical studies that minimize the set of experimental variables in order to focus on a minute set of factors (DeFond et al. 1999). Our findings suggest that ownership structure has an innate ability to affect the efficiency and effectiveness of corporate governance. When the primary incentive for securities firms to better their corporate governance mechanisms is heavy regulation and the threat of government penalties, firms with certain ownership structures are less likely to be well-governed and therefore are more prone to scandals. Our findings call for more institutional features to support effective governance. They have policy implications for improving the efficiency of China's securities industry and capital markets. In addition, our paper provides evidence that international studies of corporate governance would benefit from controlling for ownership structure differences across economies.

The paper is organized as follows. Section 2 provides the institutional background of the development of the stock market and securities firms in China, which has resulted in their unique ownership patterns. Section 3 presents our hypotheses and Section 4 describes the sample. The methods we used in the study are reported in Section 5. Discussions of the results, our conclusions, and suggestions for future research are in Section 6.

## **Institutional Background**

Securities firms in China are unique in their ownership structure due to the relatively recent development of the Chinese stock market and China's securities industry.

### **The Development of the Chinese Stock Market**

China's domestic stock exchanges, the Shanghai Stock Exchange (SHSE) and the Shenzhen Securities Exchange (SZSE), were opened by the Chinese government in the early 1990s to raise capital and improve the operating performance of state-owned enterprises (SOEs) (Bai et al. 2004). As of February 2008, SHSE and SZSE together ranked ninth among the largest stock exchanges in the world with their combined market capitalization of over \$3500 billion. Chinese companies and the country's entire economy

have benefited enormously from the rapid growth and extraordinary expansion in the stock market since 1990.

The advances in the Chinese stock market have not been without difficulties. Problems have included high initial public offering underpricing, market segmentation, and high stock-market return volatility (Su and Fleisher, 1997). Additionally, the market was plagued by corporate scandals, particularly between 2002 and 2006 when thirty-six securities firms (more than one fourth of the total industry) were delisted or closed down by the China Securities Regulatory Commission (CSRC), the government agency with the authority to make and enforce rules regarding corporate governance whose measure is to ensure investment quality of business as well as to enforce disclosure requirements (Clarke, 2003). Liu and Sun (2005) studied the State shareholding composition in Chinese listing firms, while Wei, et al, (2005) studied the relation of ownership structure and firm value in China's private firms. Chen, et al. (2009) also studied the relation between ownership concentration and firm performance in China.

### **The Development of Securities Firms in China**

The scandalous bankruptcy of many securities firms and the prevalent and continuous losses across the industry since 2000 are not incidental. Chinese securities companies have been established and developed relatively recently along with the stock market. The first set of Chinese securities companies emerged in the mid-1980s as affiliates of central and local banks and government agencies. The services they provided mainly consisted of the issuance of government Treasury bills and limited issuance and exchange of corporate bonds and stocks. However, with the establishment of the Shanghai Stock Exchange and the Shenzhen Securities Exchange in the early 1990s, securities firms grew rapidly in both number and functions. This growth took place with little regulatory or policy guidance, through primitive market mechanisms, with state-owned companies as clients. In response to the misconduct of many of the securities firms and in response to the control of the banks over the securities industry, the Chinese State Council implemented the Reform of Financial Systems in December 1993 with the goal of separating the securities firms from their affiliated commercial banks. Consequently, securities companies gained legal independence and enjoyed a certain level of operational autonomy. At the same time, privately owned securities firms were founded. Major mergers and acquisitions among securities firms followed. Foreign capital was introduced to securities firms after China joined the WTO in 2001. Subsequently, the securities industry enjoyed a rapid increase in number of companies, in market capitalization, and in market shares.

The bear market in China between 2001 and 2005 was accompanied by a massive fallback in the securities industry; three-fourths of securities companies suffered losses. Thirty-six securities firms (more than one fourth of the total industry) were delisted or closed down by the CSRC. Despite tight regulations, investigations into securities firms continuously revealed poor corporate governance and inadequate internal controls. Three factors made it possible for securities firms to appropriate customer funds: restriction of services provided; lack of financing channels resulting from separation of the banking and securities industries; and defects in the client deposit and certificate custody system.

### **Ownership Structure of Securities Firms in China**

As noted above, Chinese securities firms have unique ownership structures due to the historical development of the Chinese stock market and the securities industry, during which ownership of securities firms changed from banks to local governments, or to private, sometimes foreign hands. In this study, therefore, we divide the securities firms into four groups based on their ownership structure: Origin group, Separation group, Control group, and Private group. The first two types of securities firms originally belonged to the central or local banks. Firms in the Origin group are now owned by the local governments. Firms in the Separation group have been transferred to state-owned enterprises (SOEs). These firms are owned by the State, and the shareholder ownership is usually vaguely and indirectly represented since there are no concrete individuals to act upon the State's interests. The chairs or CEOs of such firms are government appointed and usually have full control over the process of decision making. A third type of securities firm is the Control group, which consists of independent firms that only provide services in the finance industry. They are usually held by a block holder with dominant interest and substantial voting control. The last group, the Private group, comprises of privately owned securities firms that have little or no state ownership. Firms in the Private group are also usually controlled by a majority owner.

### **Research Hypotheses**

Corporate governance is commonly viewed as a system that delineates the rights and responsibilities of each major group of stakeholders in a company, and sets rules and procedures for making decisions about company affairs (OECD, 1998). It can also be viewed as the design of institutions and mechanisms that induce or control board directors and management to best serve the interests of shareholders and other stakeholders in a company and to resolve conflicts among them, subject to the constraints of economic, legal, and ethical norms (Ho, 2002). The traditional agency framework is anchored in the separation of ownership and control (Shleifer and Vishny 1997). Information asymmetry and incomplete contracts give the managers significant control rights (discretion) over how to allocate investors' funds (Shleifer and Vishny, 1997), thus making way for managerial expropriation in both direct (absconding with the money) and indirect ways (transfer pricing, tunneling, or entrenching). Such insider control problems can be mitigated by incentive contracts, but such contracts can be expensive and create many opportunities for the managers to self-deal, especially if the contracts are negotiated with a poorly motivated board of directors.

Another solution to curb managers stealing is to align cash flow and control rights of outside investors by concentrating share holdings (Denis and McConnell, 2003). A substantial shareholder is motivated to collect information and monitor management, and also has enough voting control to pressure management in some cases (Shleifer and Vishny, 1997). The problem with large shareholders is that they themselves may expropriate other shareholders, hence creating a second type of agency cost, block holder expropriation.

A considerable amount of empirical evidence has documented the prevalence of managerial behavior that does not serve the interests of investors, both in the U.S. and other countries (See Denis and McConnell, 2003 for a review.). According to Shleifer and Vishny (1997), evidence regarding the role of large shareholders in exercising corporate governance has been primarily positive across the globe. However, the impact of ownership structure on the two types of agency costs - managerial expropriation (insider problems) and block holder expropriation has been less studied.

The securities firms in China provide a useful context in which to examine the impact of ownership structure on agency costs. Despite majority ownership, the state does not exercise effective control over its firms in the Origin and Separation groups. The control of the companies rests primarily with the insider-managers, who are often in turn controlled and supported in various forms by their Communist Party and ministerial associates who do not always act in the interest of the shareholders. The controlling authorities have no incentives to select the best managers or to ensure that companies are efficiently and profitably operated (Lin, 2004). As a result, the managers are easily in the position of controlling every aspect of decision making without proper monitoring, often resulting in poor operating performance. On the other hand, firms in the Control and Private groups are held by block holders with a keen interest in the company performance. These block holders are more likely to function well as members of the boards of directors, and are therefore less likely to suffer from managerial expropriation. However, such firms are prone to block holder expropriation since the large shareholders usually prevail when they have the incentive to do so. Therefore, our first two hypotheses are as follows:

Hypothesis 1. Firms in the Control group and Private group experience more block holder expropriation than firms in the Origin group and Separation group.

Hypothesis 2. Firms in the Origin group and Separation group experience more managerial expropriation due to insider control than firms in the Control group and Private group.

The Code of Corporate Governance in China recognizes the “Three Meetings” (shareholders’ meetings, directors’ meetings, and supervisors’ meetings) as important aspects of corporate governance. The Code includes specific rules relating to the “Three Meetings.” Firms with more frequent “Three Meetings” are more protective of shareholders’ rights and more transparent in performance assessments of directors, supervisors, and management personnel. Firms in the Control and Private groups are more motivated to engage in “Three Meetings” to meet the needs of their block holders. In contrast, firms in the Origin and Separation groups are less motivated to engage in “Three Meetings” because they are usually vaguely and indirectly represented due to being state-owned. Therefore, we hypothesize as follows:

Hypothesis 3. Firms in the Control group and Private group conduct “Three Meetings” more frequently than firms in the Origin group and Separation group.

Establishing specialized committees in boards of directors is a common practice in international securities houses. The board of directors of a securities company may

establish a corporate strategy committee, an audit committee, a nomination committee, remuneration and appraisal committee, and other special committees in accordance with the resolutions of the shareholders' meetings. Again, firms in the Control and Private groups were shown in this study to have greater incentives to set up specialized committees to meet the needs of their block holders compared to the firms in the Origin and Separation groups that do not have such direct supervision. Firms in the Separation group were more isolated from the government and more likely to have financial expertise in their boards of directors than were firms in the Origin group, and hence were more motivated to form specialized committees. Our last set of hypotheses are:

Hypothesis 4a. Firms in the Control group and Private group are more likely to form special committees than firms in the Origin group and Separation group.

Hypothesis 4b. Firms in the Separation group are more likely to form special committees than firms in the Origin group.

### **Data**

Our sample consists of 369 securities firms in China with data collected from 2003 to 2005 as shown in Table 1. For the shareholder structure, Table 1 shows that firms in the Origin group have a higher average number of shareholders (23.74) than firms in the other three groups. This is mainly due to the fact that they were the first large securities companies in China to come into existence. The disclosed ownership concentration of the sample has an average of 39.97%, with the highest of more than 50% in the Control group. There is no significant difference between the disclosed and the actual ownership concentration for firms in the Origin and Separation groups, while the actual ownership concentration for firms in the Control and Private firms is significantly higher than firms in the Origin and Separation groups.

Table 2 shows variable definitions. Tables 3 and 4 summarize the descriptive statistics for all the variables. Table 3 shows that the size of board of directors is on average 9, with no significant difference among the four groups. Independent directors count for only ten percent of the board; half of the sample does not have any independent director. Firms in the Control and Private groups have more independent directors, a greater percentage of independent/insider directors, and a greater percentage of directors from controlling shareholders than those in the Origin and Separation groups, thus showing that they are more likely to exert shareholder control over management. There is no significant difference across the groups with regard to the percentage of directors from controlling shareholders. Regarding the "Three Meetings", the average number of directors' meetings is 3, shareholders' meetings is 1, and supervisors' meetings is 1. Some companies have 0 "Three Meetings" in some years. Firms in the Control and Private groups hold more "Three Meetings" than do those in the Origin and Separation groups, again showing that they have better shareholder monitoring. Table 4 shows that eighty percent of the Chairs in the Control and Private groups are appointed from the controlling shareholders; while less than twenty percent were appointed from the controlling shareholders in the origin and separation groups. The Chairs are also the CEOs in more than a quarter of the

**Table 1 Shareholder structure of Chinese securities firms**

	N	Number of shareholders: Mean (Median)	Ownership concentration <sup>2.a</sup>		Statistics	
			Disclosed	Actual	T-stat.	Z-stat.
<b>Total</b>	369	16.5 (9)	39.97 (23.41)	44.066 (24.71)	1.52 (0.129)	1.53 (0.127)
<b>Classification based on ownership structure</b>						
<b>Origin group</b>	129	23.74 (11)	36.97 (23.54)	36.97 (23.54)	-	-
<b>Separation group</b>	105	13.25 (8)	43.44 (25.40)	44.86 (24.79)	0.24 (0.813)	0.38 (0.775)
<b>Control group</b>	78	10.65 (6)	52.60 (18.80)	60.38 (20.88)	1.38 (0.173)	1.19 (0.232)
<b>Private group</b>	57	13.17 (7)	22.64 (11.94)	40.81 (24.35)	2.93 (0.007)	2.47 (0.014)
ANOVA		1.79 (0.153)	7.16 (<0.001)	5.44 (0.002)		
Kruskal-Wallis		10.02 (0.018)	23.81 (<0.001)	17.48 (0.001)		
Origin group vs. Private group			t = 0.59	(p=0.56)		
Separation group vs. Private group			t = 0.65	(p=0.52)		
Control group vs. Private group			t = 2.76	(p=0.01)		

<sup>2.a</sup> Ownership concentration is the ownership by the controlling shareholder. The disclosed concentration comes from the companies' financial statements and the actual number is computed as the sum of the combined ownership by the controlling shareholders.

**Table 2 Variable definitions**

Variable	Variable description
Committee	Dummy variable that equals 1 if there is more than one specialized committees, and 0 otherwise.
Conference	Dummy variable that equals 1 if the firms holds more "Three Meetings" than the median of the same year, and 0 otherwise.
Control	The number of or the percentage of directors from the controlling shareholder.
Dual	Dummy variable that equals 1 if the chairman is also the CEO, and 0 otherwise.
Finance	Percentage of ownership by financial institutions.
First	Actual ownership percentage by the controlling shareholder.
Government	Dummy variable that equals 1 if the chairman or CEO has government background, and 0 otherwise.
Group	Dummy variable that equals 1 if the firm belongs to Control or Private group, and 0 otherwise.
Group <sub>12</sub>	Dummy variable that equals 1 if the firm belongs to Origin group, and 0 if it belongs to Separation group.
Group <sub>34</sub>	Dummy variable that equals 1 if the firm belongs to Private group, and 0 if it belongs to Control group.
IC	Dummy variable that equals 1 if the auditor's report on internal control is qualified opinion and 0 otherwise.
Insider	The number of insider directors over the sum of the independent directors and the directors appointed by the controlling shareholder.
TA	Natural log of the firm's total capital.
Year <sub>2003</sub>	Dummy variable that equals 1 if the year is 2003, and 0 otherwise.
Year <sub>2004</sub>	Dummy variable that equals 1 if the year is 2004, and 0 otherwise.

**Table 3 Descriptive statistics for corporate governance variables across different groups of firms**

	Total	Origin	Separation	Control	Private	Statistics <sup>5.a</sup>	
						F-stat.	Chi-Square
<b>Sample Size</b>	<b>369</b>	<b>129</b>	<b>105</b>	<b>78</b>	<b>57</b>		
Size of Board of Directors	9.4	9.74	9.26	9.38	9.05	0.27	0.48
% of Insider Directors	28.7%	6.54%	7.15%	15.36%	16.03%	5.33***	14.63***
% of Independent Directors	10%	19.00%	21.69%	41.11%	39.37%	22.84***	61.31***
% of Directors from Controlling Shareholders	27.6%	30.75%	26.53%	29.12%	28.26%	0.47	2.04
Number of Shareholders' Meetings	1.5	0.25	0.40	0.77	0.66	4.05***	13.18***
Number of Directors' Meetings	2.9	0.78	1.15	1.93	1.66	9.16***	26.22***
Number of Supervisors' Meetings	1.1	4.51	4.69	7.31	6.68	4.84***	10.17**

<sup>5.a</sup> \*\*\* indicates significance at 1%. \*\* indicates significance at 5%. \* indicates significance at 10%.

**Table 4 Descriptive statistics for dummy variables with percentages in brackets**

	Total	Origin	Separation	Control	Private	Statistics	
						$\chi^2$	Fisher
<b>Sample Size</b>	<b>369</b>	<b>129</b>	<b>105</b>	<b>78</b>	<b>57</b>		
At least One Specialized Committee	213 (57.72%)	57 (44.19%)	54 (51.43%)	66 (84.62%)	36 (63.16%)	0.008	0.006
Chairman from Controlling Shareholder	153 (41.46%)	24 (18.60%)	21 (20.00%)	63 (80.77%)	45 (78.95%)	<0.001	<0.001
CEO from Controlling Shareholder	108 (29.27%)	3 (2.33 %)	12 (11.43 %)	48 (61.54%)	45 (78.95%)	<0.001	<0.001
Chairman is CEO	96 (26.02%)	42 (32.56 %)	36 (9.76 %)	6 (7.29%)	12 (21.02%)	0.073	0.056
Chairman/CEO from government	174 (47.15%)	81 (62.79 %)	69 (65.71 %)	12 (15.38%)	12 (21.02%)	<0.001	<0.001
Qualified Opinion on Internal Control	168 (43.53%)	69 (53.49 %)	57 (54.29 %)	15 (19.23%)	27 (47.37%)	<0.001	0.020



firms. This is particularly prevalent in firms in the Origin groups, revealing the traits of State-owned enterprises. Finally, auditors give qualified opinions regarding the internal controls for forty-three percent of the securities companies. More specifically, firms in the Control group have a significantly smaller number of qualified opinions from the auditors.

The descriptive statistics demonstrate the variation in the characteristics of ownership structure across firms in different groups. Overall, the results indicate that there are more independent directors, a greater percentage of independent/insider directors, a greater percentage of directors from controlling shareholders, and more “Three Meetings” for firms in the Control and Private groups.

### **Empirical Analyses and Results**

We first hypothesize that firms in the Control group and Private group have more block holder expropriation than firms in the Origin group and Separation group. We use the number and the percentage of directors from controlling shareholders as the proxy for block holder expropriation. To test Hypothesis 1, we build the following regression equation using the number/percentage of directors from controlling shareholders (Control) as the dependent variable and Group as the independent dummy variable (the dummy variable that equals 1 if the firm belongs to a Control or Private Group, and 0 otherwise) with some control variables. A significantly positive coefficient for Group proves that there is more block holder expropriation for firms in the Origin group and Separation group.

Table 5 shows that the coefficient of Group is significantly positive, thus supporting H1. In addition, the coefficient for the actual ownership percentage by the controlling shareholder is also significant, thus showing the importance of controlling shareholder ownership for block holder expropriation.

Our second hypothesis is that firms in the Origin group and Separation group have more managerial expropriation (insider control) than those in the Control group and Private group. We use the number of insider directors over the sum of the independent directors as the proxy measure for managerial expropriation. To test Hypothesis 2, we build the following regression with Insider as the dependent variable and Group as the independent dummy variable with some control variables, and expect a significantly negative coefficient.

Table 6 shows a significantly negative coefficient for the independent dummy variable Group (see Sample (1) column), thus supporting H2. Moreover, when we include Government (the dummy variable that equals 1 if the chairman or CEO has a government background, and 0 otherwise) and Dual (the dummy variable that equals 1 if the chairman is also the CEO, and 0 otherwise) as independent variables or regressors, Group lost its significance and IC (auditor’s report on internal controls) is better explained by Government and Dual. This further demonstrates the reason for more insider control in firms in the origin and separation groups.

**Table 5 Analyses on block holder expropriation (H1)**

Variable	Sample		Control and Private Group	
	(1)	(2)	(4)	(5)
Intercept	0.140 (2.86) <sup>***</sup>	0.063 (1.74) <sup>*</sup>	0.372 (5.11) <sup>***</sup>	0.450 (5.23) <sup>***</sup>
Group		<b>0.345</b> <b>(10.16)<sup>***</sup></b>		
Group <sub>34</sub>				<b>0.295</b> <b>(2.14)<sup>**</sup></b>
First	<b>0.438</b> <b>(4.52)<sup>***</sup></b>	<b>0.379</b> <b>(5.31)<sup>***</sup></b>	<b>0.544</b> <b>(3.99)<sup>***</sup></b>	<b>0.350</b> <b>(1.95)<sup>*</sup></b>
Finance	0.097 (1.32)	-0.036 (0.65)	0.038 (0.42)	0.011 (0.12)
TA	-0.006 (1.67) <sup>*</sup>	-0.004 (1.62)	-0.009 (1.14)	-0.007 (0.90)
Year <sub>2003</sub>	0.345 (1.28)	0.367 (1.39)	0.096 (0.86)	0.067 (0.73)
Year <sub>2004</sub>	0.267 (0.98)	0.254 (0.89)	0.076 (0.56)	0.087 (0.83)
F-value	13.64 <sup>***</sup>	44.82 <sup>***</sup>	6.41 <sup>***</sup>	5.86 <sup>***</sup>
Adj-R <sup>2</sup>	23.71%	58.96%	32.95%	35.56%

\*\*\* indicates significance at 1%. \*\* indicates significance at 5%. \* indicates significance at 10%.

Control The number of or the percentage of directors from the controlling shareholder.

Group Dummy variable that equals 1 if the firm belongs to Control or Private group, and 0 otherwise.

Group<sub>34</sub> Dummy variable that equals 1 if the firm belongs to Private group, and 0 if it belongs to Control group.

First Actual ownership percentage by the controlling shareholder.

Finance Percentage of ownership by financial institutions.

TA Natural log of the firm's total capital.

Year<sub>2003</sub> Dummy variable that equals 1 if the year is 2003, and 0 otherwise.

Year<sub>2004</sub> Dummy variable that equals 1 if the year is 2004, and 0 otherwise.

**Table 6 Analyses on managerial expropriation - the number of insider directors over the sum of the independent directors (H2)**

Variable	Sample			Origin and Separation Group	
	(1)	(2)	(3)	(4)	(5)
Intercept	1.119 (5.93) <sup>***</sup>	0.137 (0.62)	0.143 (0.45)	0.590 (1.94) <sup>*</sup>	-0.493 (0.89)
Group	<b>-0.825</b> <b>(4.70)<sup>***</sup></b>		0.003 (0.01)		
Group <sub>12</sub>				<b>0.411</b> <b>(2.02)<sup>**</sup></b>	<b>0.386</b> <b>(1.85)<sup>*</sup></b>
Government		<b>0.853</b> <b>(5.10)<sup>***</sup></b>	<b>0.874</b> <b>(2.85)<sup>***</sup></b>		<b>0.897</b> <b>(1.89)<sup>*</sup></b>
Dual		<b>0.475</b> <b>(2.69)<sup>***</sup></b>	<b>0.464</b> <b>(2.70)<sup>***</sup></b>		<b>0.567</b> <b>(2.47)<sup>**</sup></b>
First	0.593 (1.61)	0.496 (1.22)	0.435 (1.13)	-0.922 (2.35) <sup>**</sup>	-0.900 (2.14) <sup>**</sup>
Finance	0.123 (0.43)	0.055 (0.21)	0.074 (0.31)	0.511 (1.03)	0.546 (1.06)
TA	-0.010 (0.70)	-0.014 (1.01)	-0.024 (1.10)	-0.004 (0.23)	-0.015 (0.80)
Year <sub>2003</sub>	0.654 (1.58)	0.573 (1.36)	0.468 (1.10)	0.189 (0.77)	0.177 (0.73)
Year <sub>2004</sub>	0.469 (0.98)	0.577 (1.56)	0.449 (0.86)	0.265 (0.79)	0.287 (0.91)
F-value	5.98 <sup>***</sup>	8.22 <sup>***</sup>	6.81 <sup>***</sup>	5.33 <sup>***</sup>	6.79 <sup>***</sup>
Adj-R <sup>2</sup>	14.05%	22.84%	22.38%	11.34%	20.91%

\*\*\* indicates significance at 1%. \*\* indicates significance at 5%. \* indicates significance at 10%.

- Group Dummy variable that equals 1 if the firm belongs to Control or Private group, and 0 otherwise.
- Group<sub>12</sub> Dummy variable that equals 1 if the firm belongs to Origin group, and 0 if it belongs to Separation group.
- Dual Dummy variable that equals 1 if the chairman is also the CEO, and 0 otherwise.
- Finance Percentage of ownership by financial institutions.
- First Actual ownership percentage by the controlling shareholder.
- Government Dummy variable that equals 1 if the chairman or CEO has government background, and 0 otherwise.
- TA Natural log of the firm's total capital.
- Year<sub>2003</sub> Dummy variable that equals 1 if the year is 2003, and 0 otherwise.
- Year<sub>2004</sub> Dummy variable that equals 1 if the year is 2004, and 0 otherwise.

Our third hypothesis predicts that firms in the Control group and Private group are more likely to hold the “Three Meetings” than firms in the Origin group and Separation group. We use logistic regressions to test the hypothesis. We regress Conference on Group and control variables. A significantly positive coefficient supports our hypothesis.

We find a significantly positive coefficient for Group in Table 7, thus indicating a better likelihood for firms in the control group and private group to hold the “Three Meetings”. The coefficient is still significant after controlling for the percentage of directors from the controlling shareholders as well as the number of insider directors over the sum of the independent directors and the directors from the controlling shareholders. Table 11 also includes results on individual groups. There is no significant difference between the control and private groups but firms in the separation group are more likely to hold the “Three Meetings” than those in the origin group.

Our final set of hypotheses concerns the number of specialized committees established by the securities firms. Firms in the Control group and Private group are more likely to have specialized committees than firms in the Origin group and Separation group. Firms in the Separation group are more likely to have special committees than firms in the Origin group. We use logistic regressions of Committee on Group and Group<sub>12</sub> to test the hypotheses. A significantly positive coefficient on Group is consistent with Hypothesis 4a and a negative coefficient on Group<sub>12</sub> is consistent with Hypothesis 4b.

Results in Table 8 support both hypotheses. We find a significantly positive coefficient on Group, indicating that firms in the Control group and Private group are more likely to have specialized committees than firms in the origin group and separation group. The coefficient on Group<sub>12</sub> is significantly negative, meaning that it is more likely for firms in the Separation group than firms in the Origin group to have specialized committees. The results do not change after controlling for Insider and Control.

### Conclusions

Our study demonstrates that the characteristics of their ownership structure do affect the corporate governance of securities firms in China. More specifically, firms in the Control group and Private group experience more block holder expropriation while firms in the Origin group and Separation group experience more managerial expropriation due to insider control. Furthermore, firms in the Control group and Private group are more likely to hold the “Three Meetings” frequently and form specialized committees than firms in the Origin group and Separation group, providing shareholders with more protection against managerial expropriation. Meanwhile, firms in the Separation group are more likely to form specialized committees than firms in the Origin group.

Our findings suggest that ownership structure has an innate ability to affect the efficiency and effectiveness of corporate governance. The findings of this paper have policy implications for improving the efficiency of China’s securities industry and capital markets. They call for more institutional features to support effective governance such as improving disclosure and the supervision of insider and related party transactions as well as developing a long-term incentive compensation system for directors and

Table 7 Analyses on the “Three Meetings” (H3)

Variable	Sample		Origin and Separation groups		Origin and Private groups	
	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	0.010 (0.00)	0.108 (0.04)	1.168 (2.93)*	1.265 (3.11)*	-0.697 (0.55)	-1.502 (1.43)
Group	<b>1.129</b> <b>(6.89)***</b>	<b>0.911</b> <b>(3.69)*</b>				
Group <sub>12</sub>			<b>-0.630</b> <b>(1.39)</b>	<b>-0.588</b> <b>(4.32)**</b>		
Group <sub>34</sub>					<b>-0.112</b> <b>(1.12)</b>	<b>0.206</b> <b>(0.59)</b>
Insider		<b>-0.126</b> <b>(2.87)*</b>		<b>0.127</b> <b>(3.23)*</b>		
Control		<b>0.398</b> <b>(1.10)</b>				<b>2.010</b> <b>(1.32)</b>
First	-1.051 (1.40)	-1.123 (1.64)	-2.767 (5.31)**	-2.643 (4.70)**	-2.390 (1.68)	-1.336 (0.42)
Finance	-0.293 (0.19)	-0.280 (0.17)	-0.898 (1.21)	-0.912 (1.57)	-0.988 (0.72)	-1.059 (0.78)
TA	0.724 (3.22)*	0.729 (3.25)*	0.865 (4.92)**	0.696 (2.92)*	0.196 (1.28)	0.231 (2.15)
Year <sub>2003</sub>	1.789 (2.59)	1.573 (2.36)	0.677 (1.29)	0.549 (1.11)	0.477 (0.99)	0.349 (0.88)
Year <sub>2004</sub>	1.469 (1.78)	1.567 (1.89)	1.119 (0.98)	1.000 (0.88)	1.134 (1.18)	1.223 (1.28)
Chi-Square <sup>c</sup>	12.36**	12.93**	11.98**	12.23**	3.91	4.96
-2 log L	169.86	174.67	107.69	112.02	61.09	57.29

\*\*\* indicates significance at 1%. \*\* indicates significance at 5%. \* indicates significance at 10%.

Control The number of or the percentage of directors from the controlling shareholder.

Finance Percentage of ownership by financial institutions.

First Actual ownership percentage by the controlling shareholder.

Group Dummy variable that equals 1 if the firm belongs to Control or Private group, and 0 otherwise.

Group<sub>12</sub> Dummy variable that equals 1 if the firm belongs to Origin group, and 0 if it belongs to Separation group.

Group<sub>34</sub> Dummy variable that equals 1 if the firm belongs to Private group, and 0 if it belongs to Control group.

Insider The number of insider directors over the sum of the independent directors and the directors appointed by the controlling shareholder.

TA Natural log of the firm's total capital.

Year<sub>2003</sub> Dummy variable that equals 1 if the year is 2003, and 0 otherwise.

Year<sub>2004</sub> Dummy variable that equals 1 if the year is 2004, and 0 otherwise.

**Table 8 Analyses on specialized committees (H4a and H4b)**

Variable	Sample		Origin and Separation groups		Control and Private groups	
	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	0.108 (0.41)	-0.008 (0.00)	1.220 (2.49)	1.129 (2.99)	0.228 (0.34)	1.062 (1.38)
Group	<b>1.734</b> <b>(12.14)***</b>	<b>1.839</b> <b>(7.09)***</b>				
Group <sub>12</sub>			-0.777 <b>(4.56)**</b>	-0.823 <b>(4.32)**</b>		
Group <sub>34</sub>					<b>1.389</b> <b>(4.46)**</b>	<b>1.348</b> <b>(3.19)*</b>
Insider		<b>0.126</b> <b>(1.48)</b>		<b>0.117</b> <b>(2.19)</b>		
Control		<b>-0.106</b> <b>(0.85)</b>				<b>-1.754</b> <b>(2.49)</b>
First	-2.783 (6.25)**	-2.790 (5.08)**	-3.678 (6.46)**	-3.794 (6.49)**	-2.251 (1.18)	-1.489 (0.93)
Finance	0.658 (0.73)	0.661 (0.73)	-0.484 (1.45)	-0.464 (1.13)	0.239 (0.33)	0.278 (0.43)
TA	0.223 (6.87)***	0.228 (6.71)***	0.165 (4.92)**	0.162 (4.77)**	0.687 (2.78)*	0.613 (2.69)*
Year <sub>2003</sub>	0.386 (0.59)	0.574 (0.64)	1.367 (1.33)	1.549 (1.56)	0.277 (0.23)	0.249 (0.21)
Year <sub>2004</sub>	0.576 (0.78)	0.567 (0.75)	0.034 (0.03)	0.026 (0.02)	0.066 (0.69)	0.087 (0.09)
Chi-Square <sup>3</sup>	35.86***	36.04***	22.95***	23.14***	11.42**	11.94**
-2 log L	167.57	169.43	107.95	112.28	53.86	53.95

\*\*\* indicates significance at 1%. \*\* indicates significance at 5%. \* indicates significance at 10%.

- Control The number of or the percentage of directors from the controlling shareholder.
- Finance Percentage of ownership by financial institutions.
- First Actual ownership percentage by the controlling shareholder.
- Government Dummy variable that equals 1 if the chairman or CEO has government background, and 0 otherwise.
- Group Dummy variable that equals 1 if the firm belongs to Control or Private group, and 0 otherwise.
- Group<sub>12</sub> Dummy variable that equals 1 if the firm belongs to Origin group, and 0 if it belongs to Separation group.
- Group<sub>34</sub> Dummy variable that equals 1 if the firm belongs to Private group, and 0 if it belongs to Control group.
- Insider The number of insider directors over the sum of the independent directors and the directors appointed by the controlling shareholder.
- TA Natural log of the firm's total capital.
- Year<sub>2003</sub> Dummy variable that equals 1 if the year is 2003, and 0 otherwise.
- Year<sub>2004</sub> Dummy variable that equals 1 if the year is 2004, and 0 otherwise.

executives (Lin, 2004). In addition, our paper provides evidence that international studies of corporate governance would benefit from controlling for ownership structure differences across economies.

### **Acknowledgements**

We would like to thank Weiguo Zhang, C. Jevons Lee, Xiao Chen, Chao Chen, Zhengbiao Yu, Derjen Xie, and Margaret Palisoc for their helpful suggestions. The authors thank Dr. Sharon Myers for her help in preparing this manuscript.

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Contact email addresses: [chenrj@sem.tsinghua.edu.cn](mailto:chenrj@sem.tsinghua.edu.cn) [zhen.qi.2009@marshall.usc.edu](mailto:zhen.qi.2009@marshall.usc.edu)  
[wtlm@marshall.usc.edu](mailto:wtlm@marshall.usc.edu)

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