



The impact of state ownership on share price informativeness: The case of the Split Share Structure Reform in China[☆]

Wenxuan Hou^a, Jing-Ming Kuo^b, Edward Lee^{c,*}

^a The University of Edinburgh Business School, 29 Buccleuch Place, Edinburgh EH8 9JS, UK

^b Durham Business School, Durham University, Mill Hill Lane, Durham DH1 3LB, UK

^c Accounting and Finance Division, Manchester Business School, The University of Manchester, Crawford House, Oxford Rd, Manchester M13 9PL, UK

ARTICLE INFO

Article history:

Received 29 July 2010

Received in revised form 2 April 2012

Accepted 5 April 2012

JEL Code:

G14

G15

G30

G38

Keywords:

State ownership

Share price informativeness

Split Share Structure Reform

China

ABSTRACT

This study examines the impact of state ownership on share price informativeness using the unique setting of the Split Share Structure Reform in China. This reform abolishes the trading restriction on shares held mainly by state shareholders. In doing so, it renders state shareholders' wealth more sensitive to share price movements and decreases their conflict of interests with private shareholders. This change is expected to strengthen the corporate governance incentives of state shareholders and reduce the information asymmetry in Chinese listed firms. This prediction is confirmed through empirical evidence of increased share price informativeness among firms that are more sensitive to the impact of this reform, i.e. those with more state ownership or restricted shares. These findings imply that this reform benefits the information environment and minority shareholders in the Chinese stock market.

© 2012 Elsevier Ltd. All rights reserved.

1. Introduction

China's Split Share Structure Reform (e.g. Firth, Lin, & Zou, 2010) that started in 2005 marks a major change in the institutional setting of the Chinese stock market. Prior to this reform, state shareholders mainly held restricted shares that could not be freely traded in the stock market in the same way as shares held by private shareholders. This created a conflict of interest between state and private shareholders, since share price movements in the capital market did not affect the wealth of the former. As a result, the widespread concentration of state ownership in Chinese listed firms (e.g. Allen, Qian, & Qian, 2005) induced a lower incentive alignment effect and a greater entrenchment effect, which in turn reduced corporate governance and transparency (e.g. Gul, Kim, & Qiu, 2010). The reform abolishes this split share structure and causes state shareholders' wealth to become sensitive to share price movements. This should align the incentives of state and private shareholders to monitor and ensure managers maximize the market value of their firms.

This study examines whether the reform has improved the corporate transparency of Chinese listed firms through their share price informativeness. This is an important question because corporate transparency facilitates the efficient allocation

[☆] The authors would like to thank the Editors, two anonymous referees, as well as participants at the European Financial Management Association 2010 Annual Meetings at Aarhus, Denmark for useful comments.

* Corresponding author. Tel.: +44 161 275 4564.

E-mail address: edward.lee@mbs.ac.uk (E. Lee).

of financial resources in the capital market, which is essential to economic development and growth. To meet the growing interest among academics, policy makers, and practitioners in the economic development of China, this study provides empirical evidence verifying the impact of a major reform on the information environment of the Chinese capital market. Contributing to the corporate governance literature, which largely focuses on developed countries (e.g. Dennis & McConnell, 2003), this study provides empirical evidence from an emerging country with a unique research setting of an exogenously reduced conflict of interests between shareholders.

The influence of governance mechanisms on corporate transparency is well established in the literature (see Section 2.2 for a review). The separation of ownership and control leads to information asymmetry between corporate insiders and external stakeholders (Jensen & Meckling, 1976). Managers and controlling owners, with more opportunities to expropriate wealth from outside investors, have greater incentives to conceal their self-serving deeds by withholding information or window-dressing performance (Shleifer & Vishny, 1997). Such opportunistic behaviors should reduce when corporate governance becomes more effective. This should also increase the information content and credibility of firms' disclosure, causing more firm-specific information to be included in the share price. Thus, increased share price informativeness among Chinese listed firms, following the Split Share Structure Reform, could reflect a corporate governance improvement.

This corporate governance effect is generated mainly through the incentive alignment between controlling and minority shareholders and not necessarily through changes in ownership structure or control. Such alignment occurs despite the reform's gradual implementation process (see Section 2.3 for details) and applies to state shareholders who do not immediately sell their shares. There is the concern that this incentive alignment might not be realized if state shareholders do not believe that the Chinese government will relinquish its control on listed firms and thus that the tradability of their shares is only symbolic. This concern is mitigated in two ways. First, well-established government policy seeks to focus state influence on strategically important sectors only. Second, media anecdotal evidence confirms that some state shareholders have begun actively trading their shares following the lifting of restrictions.

Given the aforementioned arguments, this study hypothesizes that the Split Share Structure Reform should increase the share price informativeness of Chinese listed firms, especially those with a higher proportion of state or restricted shares, since the impact of the reform is expected to be more pronounced among such firms. To test this assertion, this study samples Chinese firms listed on the Shanghai and Shenzhen stock exchanges over the period of 2001 to 2008.¹ Among firms with a higher proportion of state or restricted shares, the empirical analyses reveal lower share price informativeness prior to the reform and a greater increase in share price informativeness following the reform. These results are robust to the control of firm characteristics and governance variables, as well as industry and regional effects. These findings are also not sensitive to estimating share price informativeness by alternative models and data frequencies.

The rest of the paper is organized as follows. Section 2 discusses the literature and hypotheses. Section 3 describes the sample and methodologies. Section 4 presents the empirical findings. Section 5 concludes.

2. Literature and hypotheses

2.1. Ownership structure and corporate governance

Ownership structure affects corporate governance through two opposing effects: incentive alignment and entrenchment. The incentive alignment effect occurs when the profit, or firm value, maximization objective of the minority shareholders is consistent with that of large shareholders, who in turn also have more expertise and capability to monitor managers (e.g. Shleifer & Vishny, 1986). Empirical evidence confirms this by showing that firms with large shareholders are associated with higher management turnover (Kang & Shivdasani, 1995) and tighter executive compensation control (Hartzell & Starks, 2003). Gomes (2000) suggests that a high degree of ownership concentration also serves as a signal for reputation-building by controlling owners. In this context, large shareholders have more to lose from a decline in their firm's value than they could gain from diverting their firm's cash flow into their own pockets.

The entrenchment effect of large shareholders is conceptually similar to the effect when managerial ownership is high. Theoretical (e.g. Stulz, 1988) and empirical (e.g. McConnell & Servaes, 1990) studies suggest that managers with a greater degree of ownership have more incentive to expropriate the wealth of outside shareholders, which in turn reduces the value of the firm. Shleifer and Vishny (1997) argue that large shareholders who gain effective control of a firm's management also have a greater incentive to pursue their own interests, which are not necessarily the interests of other investors. Johnson, La Porta, Lopez de-Silanes, and Shleifer (2000) confirm that controlling shareholders transfer assets and profits out of the firm for their own benefit, and call this "tunneling". Claessens,

¹ In 2007, China imposed mandatory adoption of the International Financial Reporting Standards (IFRS) on all listed firms. As a robustness check, this study excludes the time period in which IFRS is expected to influence share price movements and acquire similar results supporting the main inference of the Split Share Structure Reform effect (see Section 4.2.4).

Download English Version:

<https://daneshyari.com/en/article/10489396>

Download Persian Version:

<https://daneshyari.com/article/10489396>

[Daneshyari.com](https://daneshyari.com)